CONTINGENT CORPORATE GOVERNANCE: A REFLECTION ON GLOBAL FRAUD AND POWER CONFIGURATIONS

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ABSTRACT

The analysis of selected international approaches to corporate governance reveals differences in the way they impact corporate power configurations and means of influence selected to gain control. Taking a power perspective, I argue that these approaches differ in their capacity to prevent corporate fraud. I call for a less uniform and more contingent approach to corporate governance that realizes the potential of both external and internal means of influence.

FRAUD: A WORLDWIDE CONTROL PROBLEM

Adelphia Communications, Banco Bilbao Vizcaya Argentina, Comroad, Dynegy, Enron, FlowTex, Global Crossing, HealthSouth, ImClone, Josephthal & Co, Kimberly Home Health Care, Learnout and Hauspie, Mitsui Trading, Northern Brands International, Olsten, Polly Peck, Qwest Communications, Royal Ahold, Schneider, Tyco, United Technologies, Venezuelan People’s Bank, WorldCom, Xerox, … – companies plagued by spectacular cases of fraud such as asset misappropriation, computer crime, corruption, organized crime or financial statement fraud proliferate. These cases are only the tip of an immense iceberg of corporate crime since many frauds are yet to be discovered, detected or made public.

A recent global fraud survey found that every second company interviewed experienced significant fraud during the last year and was affected by direct financial losses as well as the impact on reputation, management time, morale and loss of trust within teams (Ernst & Young 2003). In 13% of fraud cases, financial losses amounted to over 1M Euros. With pressure on companies to deliver short-term profits plus the growing complexity of organizational processes added to the recessionary climate in many countries, the risk of fraud is much higher today than in previous times. Since evidence shows that the worst incidences of fraud are committed by insiders, among whom those executives figure prominently who are assigned to manage and control their organizations, fraud is a crucial control problem that cannot be alleviated without effective corporate governance (Swartz and Watkins 2003).

Hence the question of how publicly held corporations should be governed is of uppermost importance to mitigate organizational risk. An analysis of corporate control issues is inextricably intertwined with the question of who should have the power to control the corporation, which in turn affects the type of goals pursued. We enter the arena of conflicting interests, power and micro-politics. Contrary to most other research studies in the field, this paper therefore takes a power perspective to discuss different approaches to corporate governance. This paper differentiates common modes of control and tentatively analyses them for their capacity to help preventing fraud.
POWER CONFIGURATIONS AND CORPORATE CONTROL

Power is one of the central ubiquitous factors behind the functioning of organizations yet it stays largely intangible under the surface of empirical reality with almost taboo-like qualities. As a result, scientific power literature – spanning disciplines as diverse as Sociology, Political Sciences, Law, Philosophy, Anthropology, Economics and Management – can be characterized by often rather abstract discussions and a tendency to avoid confrontation with empirical reality. Power as a construct remains mostly non-operationalised, which appears to preclude power theories from being suitable for the empirical analysis of issues like corporate control. Also, there is a general reluctance to approach issues of power and to discuss the use of power, or the design of power configurations, as a potentially positive creative force (Butcher and Clarke 2001).

Empirical studies on power issues – compared to the number of studies about other phenomena their number is very small – tend to over-simplify the construct of power and reduce it to single aspects of power such as control of critical resources in order to facilitate its operationalisation. Power shall be defined here broadly as the capacity to affect organizational outcomes (Mintzberg 1983, Hardy and Dougherty 1997). This definition has its roots in the power debate of Sociology and Political Science in the 1960s and 1970s and refers to power as a holistic concept consisting of three dimensions, namely resources, processes and motivation (Hardy and Dougherty 1997, Baumann 1993). Resource power is based on control over critical scarce resources such as funds, information, credibility and expertise. It enables actors to prevail in decision situations and to influence the behavior of others (Pfeffer 1981). Process power concerns organizational decision making and implementation processes such as budgeting procedures and communication. It influences organizational outcomes by controlling access to decision processes or by agenda setting (Bachrach and Baratz 1970). Motivational power shapes the preferences and aligns the interests of other actors so that the goal systems become congruent. It concerns the creation of legitimacy and shared meaning, giving direction and sense and is thus inherently a leadership task (Hardy and Dougherty 1997, Baumann 1993).

Of the only few basic theoretical frameworks of power that exist, the most holistic theory of organizational power mechanisms and their effect on corporate control that is compatible with the three-dimensional view of power can be found in Mintzberg’s configurational approach (Mintzberg 1983, Vigoda 2003). He differentiates internal stakeholders, the so-called internal coalition of actors who have major time commitments to the organization and vie among themselves for power, and all other stakeholders, who form the so-called external coalition. The interplay between these coalitions is of key importance for the current discussion of corporate governance.

According to the allocation of power, Mintzberg describes the external coalition as dominated when an individual actor or a group in consensus is a powerful influencer of the organization, as divided when power is divided up between a few competing individuals or groups or as passive when no external stakeholder seeks to exercise much power. He describes the internal coalition as personalized when a leader dominates and issues personal controls in the form of ad hoc orders, as bureaucratic when control is based on formal standards, as ideologic when an internal ideology creates dominating norms, as professional when experts control the organization with their technical skills and knowledge and as politicized when political or conflictive forces prevail.

Mintzberg discusses four typical relationships between external and internal coalitions which are based on common tendencies in organizational reality. First, if the powerful stakeholders in a dominated external coalition want to remain outside of the internal coalition and keep up their dominant position, they have to gain control without managing the organization themselves. The most effective way to achieve this is to appoint a Chief Executive Officer and to hold him personally responsible for a set of goals that can be unambiguously operationalised. As an effect, the dominated external coalition gives rise to a bureaucratic internal coalition since the behavior in the internal coalition becomes strongly centralized, formalized and standardized. Second, influence attempts of the external coalition are discouraged or defended when the internal coalition is personalized, bureaucratic, ideologic or professional. A personalized internal coalition implies a strong central leader who will be inclined to exert also some degree of control over the external coalition or will at least resist outside influence. Likewise, strong ideological norms will form internal stakeholders into a cohesive group which is likely to resist any influence from the external coalition. Also, experts dominating the internal coalition will be likely to use their expert
power to resist or even pacify outside influence. Bureaucratic controls, finally, entail standardization through behavior formalization and systems of planning and control which tend to control both internal and external stakeholders alike. A personalized, ideologic, professional or bureaucratic internal coalition therefore tends to lead to a passive external coalition. Third, conflict in one of the coalitions tends to be transferred to the other coalition. Fourth, other combinations of internal and external coalitions lack a single focus of power and are therefore likely to lead to moderate or intensive levels of conflict.

Based on these four typical relationships, Mintzberg develops a typology of six power configurations – pure types that reflect common tendencies in reality. An instrument, like many closely-held corporations for example, is a pure type power configuration dominated by an external stakeholder who dictates the goals of the organization. Displaying the first typical relationship described above, it can be characterized by a bureaucratic internal coalition and tends to be incompatible with a strong ideology or a high level of internal expertise, politics or personalized leadership control. The closed system, like many widely-held corporations for instance, has a bureaucratic internal coalition as well but faces a passive external coalition such as it can be found where external stakeholders are rather non-dominant, widely dispersed or unorganized. Closed systems follow their own system goals and discourage high levels of technical expertise, personalized controls or ideological orientation. The external coalition of the autocracy is also passive; however, the internal coalition is not bureaucratic but highly personalized and discourages political behavior, expertise and bureaucratic standards. To the extent that the single powerful leader is charismatic, this ideal type configuration can be partially ideological. The missionary displays a strong ideological internal coalition. Its internal stakeholders act in concert and try to dominate or at least pacify the external coalition. Normative control allows sharing power equally and discourages political behavior, expert power and personalized or bureaucratic controls. The meritocracy displays a professional internal coalition and usually manages to successfully parry influence attempts of external stakeholders. Since bureaucratic and personal controls tend to be weak, administrative levels often face political behavior and conflicts between different types of experts. The status differences inherent in the system of expertise mostly also preclude the egalitarianism inherent in an ideological internal coalition. Finally, the political arena can be characterized by conflict in the whole organization or a significant part of it, either pervasive or intense, and brief or of an enduring nature. The political arena often accompanies or even enables changes in organizational power, emerges in hybrid-type configurations, or speeds up organizational death.

Attempts to adapt corporate governance to better prevent fraud in corporations have to consider these power configurations. In the next section, I analyze selected international approaches to corporate governance using the configurational power perspective developed above.

### APPROACHES TO CORPORATE GOVERNANCE

The diverse facets of approaches to improve corporate governance can be classified by the way they attempt to influence the behavior of actors in corporations (see Table 1).

I differentiate the diverse attempts to control corporations into eight modes of corporate control as developed and discussed by Mintzberg (1983). These modes can be characterized by the actors seizing control, the power configurations they tend to entail as well as the external and internal means of influence needed for implementation. International examples for the respective approaches will be given and the effect on fraud prevention will be discussed.

The most radical approach to corporate control is to make a company an agent of the state and hereby transfer its economic power to the community. Nationalization implies an instrumental power configuration with the state becoming the new dominant influencer. It retains and strengthens the bureaucratic features of the internal coalition. A board of directors loyal to the government is set up to control the company and to appoint a CEO. Nationalization is implemented by external means of influence only and the internal coalition is mostly disregarded. Temporary nationalization can be observed after large companies crash, be it for fraudulent reasons or not, as in the case scenario of the Japanese Nippon Credit Bank.
Table 1: Modes of corporate control

<table>
<thead>
<tr>
<th>Mode of corporate control</th>
<th>Who is in control?</th>
<th>Implied power configuration</th>
<th>What external means of influence are used?</th>
<th>What internal means of influence are used?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nationalized control</td>
<td>Government</td>
<td>Instrument</td>
<td>Board of directors</td>
<td>Resource / process power</td>
</tr>
<tr>
<td>Democratized control</td>
<td>Employees / external interest groups</td>
<td>Political Arena</td>
<td>Board of directors, direct control</td>
<td>Process power</td>
</tr>
<tr>
<td>Regulated control</td>
<td>Government/management</td>
<td>Political Arena</td>
<td>Formal constraints</td>
<td>Resource / process power</td>
</tr>
<tr>
<td>Pressured control</td>
<td>Special interest groups/management</td>
<td>Political Arena</td>
<td>Pressure campaigns</td>
<td>Motivational power</td>
</tr>
<tr>
<td>Trusted control</td>
<td>Management</td>
<td>Closed System</td>
<td>Social norms</td>
<td>Motivational / process power</td>
</tr>
<tr>
<td>Ignored control</td>
<td>Management</td>
<td>Closed System</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Induced control</td>
<td>Management</td>
<td>Closed System</td>
<td>Economic forces</td>
<td>Resource power</td>
</tr>
<tr>
<td>Restored control</td>
<td>Shareholders</td>
<td>Instrument / autocracy</td>
<td>Board of directors</td>
<td>None / resource / motivational power</td>
</tr>
</tbody>
</table>


Can nationalized control be an answer to the prevention of fraud? What applies to issues of social responsibility at large is also true for fraud prevention: public ownership alone does not resolve the issue (Epstein 1977). By means of membership on the board of directors, nationalization could allow to prioritize fraud prevention on the organizational agenda. Implementation largely relies on resource power (sanctions for failing to comply with the system) and process power (installation of formal control systems); however its power base is limited by a lack of expertise and detail knowledge available only to stakeholders inside of the company. Moreover, nationalized control neglects motivational power and, as a consequence, the internal coalition might comply only with the letter and not the spirit of bureaucratic controls to prevent fraud. Efforts might be directed at finding loop-holes and contradictory rules to circumvent the whole system. Given the fact that the government dominating the external coalition very often consists of a diverse set of ministries and agencies with conflicting goals and given that politicians are probably not more fraud resistant than managers, it can be expected that in a nationalized mode of control fraudulent efforts might simply be diverted from a company level to a governmental level. Finally, the growing system of bureaucratic controls created by nationalization reduces general efficiency and productive dissent as well as the adaptability of the company – a cost which might most probably turn out to be too high.

A very topical issue of corporate control is to broaden the governance of the corporation by democratizing it. There are two different forms of corporate democracy with regards to a focus on external or internal means of influence. The first one, representative democracy, focuses on the composition of the board of directors as an external means of influence by either including workers or external influencers. A current announcement of the U.S. Securities and Exchange Commission to develop possible changes to current proxy regulations to improve corporate democracy is a prominent example for the diverse approaches to embrace a representative way of democratized control. The second form of corporate democracy, participatory democracy, focuses on process power as an internal means of influence. Worker participatory democracy benefits internal stakeholders by involving them in bottom-up decision-making processes. Partial forms of participatory democracy involve a limitation of bottom-up decision-making to specific decisions or to consultation and authorization instead of actual choice. Pluralistic participatory democracy signifies an inclusion of external stakeholders in internal decision making processes and is seldom referred to in approaches to corporate control.

The main value of democratization as a major fraud preventing tool lies in its capacity to induce a greater degree of transparency. Transparency of decisions, of who participates in decision-making processes, of information across organizational borders or hierarchical levels is a powerful shield against fraud. The more people are involved in decision-making by direct controls, such as full-time representatives in the decision-making process, the right to authorize certain decisions or even the right to impose a decision, and the more people are informed about the important issues of the company the harder it will be to falsify information on a larger scale and to have it go undetected. Public interest directors and other directors who are not elected at the mercy of executive management...
and the CEO are likely to be less co-opted and are less committed to the CEO, which allows them to realize their control function more independently and effectively. A system of professional directorship would greatly help in that respect. However, democratized control depends on real participation plus the skill and will of internal and external stakeholders to become active in the decision processes. Its success is directly linked to the use of motivational power as an internal means of influence – which is very often neglected by the proponents of democratized control. Instead, approaches to corporate democracy are often only directed towards aspects of process power as the formal right to participate in decision processes. This does not take into account that formal process power is very often severely limited by informal process power such as non-decision making or by resource power of knowledge and expertise. Equally, such approaches neglect that the capacity of third parties to increase transparency and strengthen the system of control is limited by their lack of insider knowledge and by the CEO’s means of influence.

*Regulated control* of economic activities can be found as early as 2350 before Christ, when the Mesopotamian Edict of Urukagina introduced an administrative reform. Using the judicial system or special regulatory agencies for the imposition of laws and regulations, government in the regulated mode of control plays a more active role in an increasingly divided external coalition to control decisions and actions in companies. The high impact of recent corporate fraud scandals led to a growing international avalanche of regulations with focus and emphasis on governance issues. The regulated mode of control is based on formal constraints coupled with official sanctions, which usually obstruct actions instead of initiating them. Regulators can also use internal means of control by prescribing specific processes, such as external auditing or the election of the CEO, or by influencing resource power with the requirement of trained experts for specific jobs. Regulated control acknowledges a governmental right to constrain the power of the corporation but accepts management to freely act within the given legal framework.

The capacity of regulated control to punish offenders by imposing formal constraints is indispensable in the prevention of fraud because of a deterring effect – the Italian False Accounting Bill of 2001, which drastically reduces the penalties for guilty managers, being an example of a counter-productive regulation. The Sarbanes-Oxley Act in the U.S.A. of 2002 was designed to implement harsher civil and criminal penalties for persons violating securities laws, among its other objectives. It is exemplary in terms of increasing the deterring effect of regulation by increasing personal liability of board members and managers, strict enforcement and severe punishment. Regulated control facilitates adequate means to tackle issues such as disclosure of information and risk by demanding disclosure of related party transactions of non-executive directors or remuneration of directors. Finally, by forcing all participants to comply with the same standards, regulations can help to avoid situations of a “prisoner’s dilemma” where businesses are forced to adapt to the behavior of the least moral participant in order to survive. However, there are several “downsides” to preventing fraud by regulating companies. First of all, formal constraints cannot differentiate between specific companies. An effective prevention of fraud, however, would certainly have to take into consideration the diverse fraudulent risks of companies with different power configurations. Secondly, formal constraints set only minimum standards which constrain unacceptable behavior and it may be possible to fully comply with the law and still act in an unethical way. Given that management has insider knowledge not available to regulators, there is a high probability that ethically fraudulent activities can be framed in a way which is not covered by regulations. The regulated mode of control neglects and often discourages motivational power, which would be needed to provoke desirable behavior. Thirdly, regulations are usually slow and applied only very conservatively, being blocked and delayed by lobbying. And finally, formal constraints are difficult to enforce because regulatory agencies are constrained by inadequate budgets, personnel problems, co-optation by industry, and political decisions that limit the agency’s effectiveness.

Special interest groups use * pressured control* to effect changes in corporate behavior by threatening to use pressure campaigns as an external means of influence. The campaigns also affect motivational power by influencing internal stakeholders. The aim of pressure campaigns, which can comprise press attacks, demonstrations, boycotts, strikes or even sabotage, is to informally influence decisions taken by management.

Pressured control has significant fraud preventing effects. First, it can originate in a multiplicity of forces, which creates an element of uncertainty about external influence in the corporate power configuration. Pressure campaigns are therefore difficult to predict and companies cannot simply counter pressured control efforts or co-opt
and neutralize key actors of the campaigns. Thus, the mere possibility of the emergence of a pressure campaign serves to police companies and make them refrain from fraudulent behavior or induce them to proactively improve their internal control systems. Second, pressured control is fast, informal, focused on specific issues and highly flexible. It can immediately react to the specifics of a company and foil attempts to circumvent regulations or social norms. Third, pressured control has the potential to use motivational power in order to raise the consciousness of the general public and of employees within a specific company about issues related to ethical behavior and the prevention of fraud. It can eventually effect a change in social norms or the introduction or change of formal constraints. However, pressured control is restricted to the notion that companies have to be forced to prevent fraud and seeks confrontation instead of co-operation. Also, it is severely restricted by limited access to insider information – especially of an ethically questionable or even fraudulent kind. Therefore, the fraud preventing effect of pressure campaigns is limited to fear of loss of corporate image when fraud becomes public and to the imposition of certain approaches to corporate governance such as the separation of the roles Chairman of the Board and CEO.

In the mode of **trusted control**, managers retain control because they are trusted to be socially responsive and to exercise power responsibly. The external coalition remains therefore passive. However, the external coalition tries to influence the corporation by socializing its managers via social norms that call for ethical behavior – which can be seen by increasing demands to offer more classes in business ethics at business schools.

Trusted control is needed for effective fraud prevention since there is always some degree of discretion available to managers when decisions are made – for instance, in the way some managers respond to unethical behavior, fraudulent opportunities, or whistle blowing (Alford 2001). Without responsible and ethical managers, there will always be a way to commit fraud, no matter how tight the other systems of control may be. Trust is also needed where formal constraints meet compliance or where the company possesses superior knowledge and can therefore mislead stakeholders. In order to implement an efficient system of trusted control within a company, motivational power, as an internal means of influence, must be used to make employees adhere to ethical standards in their daily lives. Also, motivational power must be used to help them regain a sense of purpose and mission and to let them become emotionally attached to their company – moving away from utilitarian bureaucracy towards a more ideological or, where possible, personalized internal coalition. The success of trusted control to prevent fraud depends on process power in order to adapt performance measurement systems to include ethical behavior and actions to prevent fraud. Since external stakeholders have only limited access to internal means of influence, the effectiveness of trust for fraud prevention relies on the willingness and capability of corporate management to skillfully apply internal means of influence for fraud prevention. To rely solely on trusted control would mean to close one’s eyes to the current wave of fraudulent behavior. In combination with other modes of control, however, trusted control appears to be an indispensable component of effective fraud prevention.

In the mode of **ignored control**, managers retain control because they are considered to act ethically since it is naturally in their best economic self-interest and it simply pays to be good. Management tries to keep the external coalition passive so that their power base in the closed system configuration is retained. If management succeeds in these efforts, no means of internal influence will be used by external stakeholders to influence the power configuration. This does not imply that management stays passive with regards to fraud prevention. However, it is only motivated by direct rewards or expectations of a return on investment in fraud prevention, such as the evasion of bad publicity, punishment or regulation. The most prominent example of attempts to preserve an ignored mode of control is the development of voluntary standards for corporate governance. In many countries, voluntary codes have been set up to improve corporate governance, such as the COSO (U.S.A.), CoCo (Canada), and Cadbury (U.K.), or the Vienot Report (France, 1995 and 1999), the Code of Best Practice (Germany, 2000), the Preda Code (Italy, 1999), The Peters Report (The Netherlands, 1997), The King Report (South Africa, 1994, 2002), or the Swiss Code (Switzerland, 2001), to quote some examples (KPMG 2002).

A positive aspect of ignored control is that it is sometimes easier to argue with economic self-interest than with issues based on ethical values. Hence, ignored control can be used as a pretext to implement trusted control. However, fraud prevention in the ignored mode of control in its true meaning appears to be much less effective than in a trusted control mode: ignored control often becomes a purely political tool in order to maintain the status quo of power. Also, it encourages average behavior and results therefore in weak systems of fraud prevention and internal control. Moreover, the structural changes demanded by voluntary codes do not necessarily change the conduct and
behavior of the board of directors (Pettigrew 2002). Ignored control therefore tends to lead to general pronouncements instead of real actions to prevent fraud: as an example, a recent study showed that 55% of British FTSE-350 fail to meet even the minimum recommendation of the Turnbull voluntary code of corporate governance and as much as 80% fail to truly embrace its principles (Grant Thornton 2003). As a consequence, ignored control failed to keep regulatory agencies and legislative bodies in many countries from resorting to regulated control by introducing formal constraints.

Induced control means that managers in companies facing an induced mode of control retain control but special economic incentives have to be set to make them act responsibly. The external coalition stays largely passive and simply concentrates its influence attempts on the economic forces of incentives and resource power within the company. It implicitly accepts the status quo of the power configuration.

Inducements can be effectively applied inside of companies. If incentives are not limited to economic incentives but touch also the bases of motivational power, and if measures are designed holistically, are not limited to financial issues and consider also the way how results are achieved, internal measurement and incentive systems such as the balanced scorecard can turn out to be drivers of good practice, ethics and fraud prevention. However, effective incentive setting and measurement implies active control and continuous adaptation of the system – a prerequisite that is not compatible to the mode of induced control: induced control builds on a largely passive role of the external coalition and the idea that it is sufficient to simply set inducements for social goals such as ethical behavior to be realized automatically. Moreover, the implied assumption that all relevant behavior can be reasonably measured and that measures are valid, cannot be circumvented and have the capacity to prevent harmful and induce desired behavior is not always warranted. Since badly designed incentives and measures are very likely to have undesired effects, the design and continuous adaptation and maintenance of the internal measurement and incentive systems should be a task of key importance – a task that has to be actively performed. Also, it should never be trusted as the sole means of fraud prevention. This shows that setting inducements as a potentially positive motivating approach to exert control inside of a company may not be confused with induced control as an approach to corporate control for the external coalition. The external coalition in this mode of control is not only rather passive, but also almost completely dependent on the willingness and co-operation of insiders at the design, control, and application stage of measurement and incentive systems. Given the great difficulties to set incentives and measure complex, often nonprogrammable behavior inside of an organization, the application of induced control by outsiders such as shareholders or government agencies as a means to prevent fraud appears to be not promising. Rather, it should be limited to situations where companies can help to prevent fraud outside of their realm, for example in industries or supply chains. Hypothetical examples for induced control would be tax exemptions for ethically responsible companies, or the granting of a reward for whistle blowers or external informants that help to stop fraudulent behavior.

Under restored control, owners force the organization as their instrument to pursue economic goals only. Proponents of the restored control mode see the origin of fraud in the fact that shareholders have lost control over a board of directors selected by a much too powerful management. As a prerequisite of restored control, the external coalition must shift from the passive to the dominated form, thereby rendering the power configuration into an instrument or, in less frequent cases of smaller companies, into an autocracy. Examples of moves to further this form of control can be seen in numerous governmental interventions to change voting procedures and to give the shareholders more effective control over the board of directors.

Various reasons make restored control appear to be a less effective way to prevent fraud. In the view of power theory, restored control suffers from a power imbalance between executives and shareholders. Restored control cannot provide a solution to the control problem arising from a passive external coalition since executive management can source from four power bases of their own (Grabke-Rundell and Gomez-Mejia 2002): first, the willingness of dispersed shareholders to control management has to be doubted because the free stock market tends to detach ownership from control and render shareholders passive. Second, executive management usually becomes entrenched via internal directors or as a consequence of long executive tenure on the board. The board of directors is largely selected by management since management slates usually pass elections without changes; therefore, the exercise of independent judgment is severely limited. Third, directors often do not have the time and information needed in order to closely control management. Fourth, even if some directors managed to dedicate themselves
actively to their control task, the large number of directors and the nonprogrammable nature of management tasks would severely constrain single active directors to have a decisive control over management. As a consequence, restored control may have significant impact on management control only where owners are fully involved, as members of the internal coalition and with strong psychological attachment to the company, as it is the case in an autocracy where a dominant shareholder acts as CEO. In this case, the owner could tap into the rich base of internal means of influence, above all resource and motivational power, in order to ensure adequate fraud prevention. However, for the majority of publicly owned corporations dispersed shareholding prevents an autocratic power configuration.

A TROJAN HORSE FOR FRAUD PREVENTION

The analysis of the effects of different modes of control on fraud prevention shows three key findings: First, no single mode of control is a panacea to cure us from all fraudulent evils in organizations. Rather, there is a need for a combination of different modes which supplement each other. Companies have to be forced by enforcing strict regulations, pressuring them relentlessly with pressure campaigns and making them more transparent and democratic to behave ethically. However, what it takes is not only external control but also intrinsic moves and commitment by our companies. Managers have to be trusted since the efficient running of a company requires them to have special insider knowledge and a high degree of discretion – no other mode of control can reduce this high potential for fraud. This implies to socialize them by “de-professionalising” them in the sense that they should be responsibly concerned with means and ends and with a corporate mission that serves society. They should feel the desire to justify the trust put upon them while running a company they feel personally involved in as owners.

Second, fraud prevention cannot be effective if all corporations are treated alike. Although this discussion was limited to publicly listed large corporations and therefore largely screened out power configurations such as the meritocracy, the missionary or the autocracy, it could be clearly seen that for fraud prevention to have an impact on our corporations it has to be adapted to the specific force field of power in and around the different companies. This demands new approaches to governance contingent on specific power configurations of individual companies.

Third, fraud can be only prevented effectively if control efforts are firmly rooted in both external and internal means of influence. The critical success factor will be hereby to win the full support of the internal coalition for fighting fraud uncompromisingly – a task which requires the use of all three dimensions of power.

To find a viable solution that integrates these three findings, we may turn to Ancient Greece and the Battle of Troia. The fortifications of corporate fraud are much too strong to be taken by external means alone. What we need is a Trojan horse of fraud prevention which operates inside of the corporations. We need a door-opener for our modes of corporate controls to really have access to confront our enemy. There are two soldiers hidden inside:

The first one is the CEO. The role of the CEO is to set the tone at the top for ethical behavior and strict prevention of fraud, not only in words and symbols but also in daily actions. This involves building a power base for the issue in the organization and giving clearly and unambiguously priority to ethical behavior. It also involves the selection of responsible people to fill the ranks in management positions and the selection of specialists for a staff position of ethics. Finally, it also means to pave the way for soldier number two:

The second one is the Internal Auditor, who is largely forgotten in current debates on corporate governance. The role of internal auditing would be one of an Ombudsman and of a catalyst for communication about moral and ethical questions. As experts for the internal control system, internal auditors drive ethics into the daily routines by integrating ethical behavior into the performance measurement systems, by ensuring that statutes and regulations further intra-organizational justice, accountability and recognition, and by specifically rewarding whistle blowers on illegitimate behavior (Alford 2001). They actively solve unintended organizational blocks which may hinder people to oppose illegal and unethical activities (Alford 2001, Waters 1978).
Thus, if there is an effective way to prevent fraudulent behavior, we may find it in a holistic and power contingent approach to corporate governance – one that is adapted to the specific power configuration of the company and integrates internal and external means of influence into a flexible force that pulls down the protective walls of corporate fraud.

REFERENCES


