GLOBALISATION, CORPORATE GOVERNANCE AND THE CONSTRUCTION INDUSTRY

Governance and the construction industry

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ABSTRACT

A defining characteristic of globalisation is the ease of trade. This characteristic has exposed a high degree of diversity and inconsistency in global business practices. As these inconsistencies increase risk, investors are identifying mechanisms to standardise business practices. A key mechanism is the application of good corporate governance practices.

Good corporate governance practices include the corporation's business behaviour in its operational environment. Investors are therefore guided as much by the financial statements as they are by the enterprise's business behaviour.

The construction industry has thus far escaped such scrutiny: however, many of its participants are being subjected to good corporate governance requirements. Governments and consumers too have due diligence expectations, much of which is being translated into statutory regulation. Regrettably, there has thus far not been a global holistic and proactive response from the construction industry as a whole.

This paper examines emerging good corporate governance expectations generally. It reviews the development of globalisation with particular reference to the establishment of a common code of conduct, undertakes a review of the definition and evolution of good corporate governance and determines its current status, assesses construction industry practices against international good corporate governance standards, and proposes an enabling framework for the industry.

Keywords: Construction, corporate governance, ethics, globalisation

Introduction

One of the characteristics of globalisation is the ease of engaging in business transactions in global financial markets. The exploration of these markets has, however, exposed a high degree of diversity and inconsistency in business practices in the various markets. As these inconsistencies increase the risk of doing business, investors are identifying various mechanisms to standardise business practices. A key mechanism is the consistent definition of and adherence to good corporate governance practices.

Good corporate governance practices extend beyond financial requirements to include the corporation's business behaviour in its operational environment. As an extension to this requirement, the operational environment, in good corporate governance terms, includes the corporation's social and environmental performance. Investors are therefore guided as much by the financial statements of an enterprise as they are by the enterprise's business behaviour.

Consumers too are increasingly supporting those products that can demonstrably show an appropriate response by the enterprise to its operational environment. Increasingly consumers are avoiding products produced by enterprises that fail in performing due diligence in the manufacturing and marketing of those products.

With the exception of listed construction enterprises, the construction industry has thus far escaped such scrutiny, for a variety of reasons. However, many of its participants, such as investors, the workforce and material manufacturers are being subjected to good corporate governance requirements. Governments and consumers too have due diligence expectations, much of which is being translated in statutory regulation. Regrettably, there has thus far not been an adequate and proactive response from the construction industry as a whole.

Contextualising globalisation

Globalisation enjoys many definitions: some define it within strictly economic terms, going so far as to embed it within the modernist capitalist model. Others define it within broader-based anthropological and sociological concerns. However, much of the literature on globalisation is polarised into diagnosing globalisation as a process leading either toward global uniformity or increasing global differentiation. Consequently, globalisation has become the prism through which to view the entire collective human condition including issues of power, religion, culture, poverty, ecology, gender, identity and the Diaspora.

Globalisation, like economies and ecologies, crosses geographical, political and religious borders. It challenges the notion of a separate nation state and shifts the paradigm from the arena of international politics to the realm of planetary politics.

There appears to be a consensus building among analysts and policy makers on some of the characteristics of globalisation the core ones being globalisation is:

1) Being shaped by developments in technology;
2) Involves the reconfiguration of states;
3) Is associated with regionalism; and
4) Is uneven (Pieterse: 2004).

There are however many more areas of controversy about globalisation, the core ones being:

1) Its very definition;
2) Whether it is economic or multidimensional;

3) Whether it is a contemporary phenomenon or is it rooted in our collective history;
4) Whether it is reality or theory;
5) Whether it is neoliberal capitalism; and
6) Most crucially, whether it is manageable.

For the purposes of this paper globalisation will be defined as ‘the process of continuing integration of human activity both empirically and at the level of the collective unconscious’ (Pieterse: 2004).

There are two core struggles occurring throughout the globalisation debate; the first is how to pursue change while preserving core values, the other is determining a management model. This struggle about core values is predicated on the assumption that high levels of social cohesion exist in any society, a rather difficult circumstance to find, and even harder to define. Perhaps this lies at the very heart of the globalisation struggle: the 21st century will be defined by the search for a new paradigm on social cohesion. The search for core values is manifest in the inclusion of social issues like poverty alleviation, job creation, human rights, corporate governance, and ethics and spirituality onto the global agenda. The second struggle – determining a management model – is playing out in global institutions such as the World Trade Organisation, the United Nations, and the World Bank.

Two of the major areas in which globalisation has a significant influence are economics and human rights.

Economics

The integration of world affairs has created a world economy that is interdependent and interconnected. A prime example is the attack on the World Trade Centre: this event in a single modern state wiped millions of dollars off global stock values and continues to impact upon thousands of air travellers around the world. Yet another example of the extent of economic integration is the ability companies have to undertake and locate their work in different countries, either in whole or in part. This is largely due to information and communication technologies facilitating a virtual 24-hour workday.

Human rights

The development of human rights is one of the areas that supports the anthropological view of globalisation: the history of the evolutionary process of human civilisation is one in which the strengthening of individual rights, as opposed to group rights, is a definite trend. In more recent times, the ease and extent to which information is capable of being spread has increased awareness of global human behavioural patterns and quality of life. The global population is now more aware of what behaviour is acceptable and what is not, and who is enjoying what quality of life and where. As an example, internal resistance is increasing in countries and societies where women and children’s rights are abused or non-existent.

Contextualising corporate governance

Establishing a proper understanding of governance is the first prerequisite to the construction of a governance framework for the construction industry. Governance is not the sole preserve of either government or corporations: governance has to do with how relationships within societies are regulated. These relationships include how governments and social organisations interact, how they relate to citizens, and how decisions are taken in a complex world (Graham et al: 2003).

Governance is therefore a dynamic interaction at global, national, institutional and community level. A significant characteristic of the globalising world is the dynamic shifting of relationships within the four sectors of society situated among citizens at large (business, the institutions of civil society, government and the media) both intra- and internationally. In many countries, governments are transferring many of their functions to national and multinational businesses either as part of a global trend toward privatisation e.g. infrastructure, or through Foreign Direct Investment (FDI) patterns. The relationship between governments and civil society is going through a similar transition driven, in part, by the notion of Public Private Partnerships (PPPs). In most countries globalisation is reconfiguring states and shifting power across borders into a broader regional context.

Since governance occurs in any form of collective action, it underscores strategic decisions regarding direction, participation and capacity. Fundamental to the strategic decisions is the dynamic interplay between core values and management, and operational ‘space’ i.e. cyber, global, national, organisational, and community. Because this process is so complex and difficult to observe, systems or frameworks are established to define how agreements, procedures, conventions or policies are made and how accountability is rendered.

Establishing a set of basic principles is the second prerequisite for constructing a corporate governance framework for the construction industry. Although there are numerous proposals suggesting basic principles, this paper has taken particular note of two specific sets of principles. The first are those of the Organisation for Economic Cooperation and Development (OECD) prepared in consultation with stakeholders from national governments, international organisations, and the private sector. The OECD identified six principles, most of which are aimed at controlling boards. However, Principle Four recognises the rights of stakeholders established by law or through mutual agreements.

The second set of principles was enunciated by the United Nations Development Program (UNDP: 1997) and has received universal acceptance: they are tabulated in Table 1 below (Graham: 2003).

Table 1. Five Principles of Good Governance

Principle	The UNDP Principles and related UNDP text on which they are based
Legitimacy and Voice	Participation – the ability to convey aspiration and preference requires freedom of association and speech and vehicles to facilitate participation Consensus orientation – the reaching of broad consensus in the best interests of the group
Direction	Strategic vision – leaders and the public share a long term perspective on good governance and human development that acknowledges historical, cultural and social complexities and what is needed
Performance	Responsiveness – institutions and processes strive to satisfy all stakeholders Effectiveness and efficiency – produce results that meet the needs while making best use of resources employed
Accountability	Accountability – all decision makers are accountable to the public and stakeholders Transparency – processes, institutions and information are directly accessible to those concerned
Fairness	Equity – opportunities for the maintenance and improvement of social well-being are available to all Rule of law – legal frameworks are fair and serve to enforce impartiality, particularly with regard to human right

The inclusion of the social dimension has become of such import due to the critical it plays in determining societal well-being. The Secretary-General of the United Nations, Kofi Annan, states *"good governance is perhaps the single most important factor in eradicating poverty and promoting development'* (Annan: 2003).

Controlling corruption has become a particular concern of many institutions, including the World Bank, since research has proved that corruption is one of the top – often the top – constraint to a firm in emerging markets (World Bank: 2004). Techniques to measure corruption and governance have developed to such an extent that it has enabled the construction of a worldwide governance databank covering about 200 countries and key aggregate indicators in areas such as rule of law, corruption, regulatory quality, government effectiveness, voice and accountability, and political instability.

The United Nations Conference on Trade and Environment (UNCTAD) has released new guidelines on eco-efficiency indicators that link environmental performance of corporations to their financial performance. Intended for both preparers and users of financial statements, they cover accounting treatment of such areas as water use, energy use, contributions to global warming, ozone-depleting substances and waste (GreenBiz: 2004).

Already securities exchanges around the world are introducing various indices to measure the social responsibility of listed companies. In Britain, the Co-operative Bank's Ethical Purchasing Index, which annually analyses the extent of ethical consumerism, calculated that the cost of consumers switching brands for ethical reasons during 2002 was \$4.6-billion in lost business. The reverse of this scenario is equally true: the total sales of ethical products rose by 44% from \$8.5-billion to \$12.2-billion between 1999 and 2002.

It has been said that if the 1800s was about entrepreneurship, and the 1900s was about management, then the 2000s will be about legitimacy. Civil society is also developing its own mechanisms to influence good corporate governance practices. The use of boycotting, recycling and second hand purchasing as a way to express personal values is an emerging trend towards greater social engagement. A new generation of consumer activists is emerging: in Britain, more than one in two people are boycotting the products of unethical companies. This may well impact directly on the material manufacturing and supplier sector of the construction industry in future, and impact indirectly on shareholding.

Integrated Sustainability Reporting

A major paradigm shift in defining corporate responsibility occurred in 1992 with the release of the Rio Declaration. This event marked a watershed in the management of the Earth's finite resources: in the three decades prior to the Rio Declaration on Environment and Development, the sustainable development debate focused predominantly on the protection of the natural environment. The Rio declaration of 1992, whilst seeking to build upon the United Nations Conference on the Human Environment held in Stockholm in 1972 developed the theme further to resolve the antagonism between environment (the green issues), and development (the brown issues).

The Rio Declaration's Principal 1 resolved to shift human beings to "the centre of concerns for sustainable development." This gathering of almost 50,000 people, among them 9,000 journalists, representatives from 16000 non-governmental organisations, indigenous peoples, religious groups, business and industry, trade unions and 114 heads of state, constituted what has been described as the inception of the Environmental Revolution.

Principal 3 requires the exercise of this development right to "equitably meet developmental and environmental needs of present and future generations." The notion of meeting the needs of today without denying future generations the ability to meet their own needs forms the substantive issue in the definition of sustainable development.

This approach later gave rise to the notion that development must be subjected to triple-bottom line auditing. Triple bottom line accounting interrogates development beyond its performance in the realm of economic viability: social well-being, and environmental stewardship are to receive equal consideration.

The relationship between business practice and societal issues took on a specific dimension in the political and social transformation process in South Africa. The Institute of Directors in South Africa released the King I Report on Corporate Governance in 1994 as the response of business to emerging global pressure for good corporate governance standards. However, the subsequent political transformation process that commenced with the election of the first democratic government in 1994, made it necessary to review the Report for relevance. The King II Report was released in 2002 with a few notable inclusions: the earlier inclusion of soft environmental issues provided for under the 'Non-Financial Matters' section in the first report was extended into "Integrated Sustainability Reporting." Essentially, this requires triple bottom line auditing.

Of greater significance, however, was the linkage between triple bottom line auditing and black economic and social transformation (King II: 2002). This linkage acknowledged the need for business to participate in the social transformation process, and to report on the contribution and progress made in that regard. The list of non-financial items requiring disclosure included the nature of and commitment to social, ethical, safety, health, environmental practices and organisational integrity; the implementation of a HIV/AIDS plan; and procurement practices, particularly in relation to Black Economic Empowerment.

This notion has now been encapsulated in law in terms of the Broad-Based Black Economic Empowerment Act (Act 103 of 2003) and requires that economic sectors agree on a set of transformation targets that are to be included in their audited statements each year. The targets are essentially socio-indicators that link social transformation of corporations to their financial performance. The progress made toward the targets determines the extent to which government will engage with enterprises in that sector.

Corporate governance and the construction industry

It is perhaps not surprising that one of the earliest known codes of law, the Code of Hammurabi dating from around the 18th century BC, contains numerous references to construction since construction is such an integral force in the development of civilisation. The code is a record of Hammurabi's legal decisions based on 282 cases dealt with in terms of Sumerian law. According to the prologue, the code exists *"to cause justice to prevail in the land, to destroy the wicked and the evil, that the strong may not oppress the weak"* (Time-Life: 1995). The reason neatly matches significant portions of the UNDP Principles of Good Governance. Regrettably, the Code raises age-old complaints against the industry: a contractor whose poor work resulted in the collapse of a structure and the death of the inhabitants could be put to death as punishment.

The construction industry remains a key developmental industry with significant economic, social and environmental responsibility, especially as the pace of urbanisation and resource depletion increases. The construction industry, which comprises both the building (residential and non-residential) and civil engineering sectors, produces physical infrastructure that alters our natural and built environment landscape. It plays an indispensable enabling role in any economy. In the process it consumes materials and resources, alters the natural and built landscapes, emits pollutants, and impacts on the lives of communities both inside and outside of its structures.

Buildings are significant users of scarce resources and significant contributors of global warming emissions and of waste (Edwards: 2002). Construction and post-construction activities consume:

1) 50 percent of all resources globally;
2) 45 percent of all energy generated to heat, light and ventilate buildings and an additional 5 percent during construction;
3) 40 percent of water used globally for sanitation and other uses in buildings;
4) 60 percent of agricultural land lost to farming is used for construction activities; and
5) 70 percent of global timber products.

Against this background, and having developed an understanding of the principles of good governance within the context of globalisation and the imperatives of sustainable development, one can move on to develop specific criteria for a framework for the construction industry.

The construction industry will have to commit to upholding the key elements of corporate governance, namely *participation, strategic vision, responsiveness, effectiveness and efficiency, accountability, transparency, equity, and rule of law*.

Adhering to the requirements of good corporate governance is of particular importance to many participants in the construction industry as many of the employers in the industry, as well as listed companies in contracting, material manufacturing and supplying are under obligation, as affected enterprises, to adhere to the provisions of the various Securities Exchanges.

A good corporate governance framework for the construction industry

Having regard for the UNDP Principles of Good Governance, and taking cognisance of the nature of construction activities, this paper proposes that an enabling framework, incorporating the following defining characteristics as indicated in Table 2 below, need to be inculcated into the business enterprises of all construction industry participants.

Table 2. Framework for the construction industry

Principal	Core value	Management indicator
Legitimacy	Participation	Promote collaborative partnerships with communities; and Work to build capacity
Direction	Strategic vision	Have clearly stated and enacted corporate values; and Understand and respect historical, cultural and social complexities
Performance	Responsiveness	Recognise the legitimacy of interested and defined stakeholders; and Ensure construction practices are efficient and socially and environmentally responsible.
	Effectiveness and efficiency	Engage with and share best practice; and Build knowledge, skill and competence
Accountability	Accountability	Perform undertakings with probity
	Transparency	Ensure that processes and information on risks and impacts are directly accessible to those concerned with them
Fairness	Equity	Engage in long-term relationships; and Respect the well-being of employees treating them fairly and with cultural sensitivity;
	Rule of law	Adopt agreed codes to tackle corruption and persist in the enforcement thereof; and Give due recognition to the respect for human rights

Conclusion

Significant progress has been made over a relatively short period to integrate the principles of justice and equity contained in Hammurabi's Code into the broader societal fabric of this globalised world.

In essence, the construction delivery process remains a complicated and complex delivery system involving multiple participants such as clients, financiers, developers, investors, professional consultants, contractors, subcontractors, specialists, materials suppliers, inspectors, and users in a dynamic process. Its impacts on the natural and built environment, the community in which it is located and the communities its serves, remain for decades and sometimes centuries.

The paper proposes a framework for the global construction industry that aligns construction enterprises with global characteristics of corporate governance. In so doing, it proposes a fundamental paradigm shift by all participants in the construction industry to enterprise development and management, a shift based solidly on probity and respect. The paper argues that such a commitment by industry participants could lead to an enabling environment for effective delivery and for growth, improved performance and continuous development of the industry. Good corporate governance is after all, about the values supporting excellence as well as the creation of an ethical culture.

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