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Learning Organization Paradigm and Its Implication on Corporate Governance

Pattaragit Netiniyom

OVERVIEW

This article devotes to the discussion the learning organization model, corporate governance issue and; the application of the learning organization concept to the implementation of good corporate governance mechanism. This involves the explanation of learning organization and agency theories on which the corporate governance issue is based. The main purpose of this paper is the discussion of how to create the efficient learning organization leading to the good corporate governance. General problems of the implication of learning organization theory on corporate governance issue are present in the last part.

LEARNING ORGANIZATION PARADIGM

The organization is defined as “a group of persons organized for a particular purpose with an administrative and functional structure (as a business or a political party); an association: a benevolent organization (Webster, 1996)”. In this paper, the organization is narrowed down to the business entity (corporate organization). Value chain money supports the existence of the organization to create a product or service. The value chain is described as the activities within and around an organization. All value activities in an organization de-

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Learning Organization Paradigm and Its Implication on Corporate Governance

Learning organization theory is developed on the condition that learning inside the organization must be equal to or greater than change outside the organization or the organization will not survive (Rayne, 1983). Learning organization means processes or activities of learning in the organization, which encourages the learning of individuals (Hedberg, 1981); therefore, it is more than a sum total of each individual member's learning. The learning by individual would create learning organization where the collective knowledge is stored (Ortendahl, 2001).

View on the learning organization can be divided into two groups. The first group led by Senge et al. (1994) proposes that the LO would be more efficient to develop from the organizational members or the individuals. On the
other hand, the second group led by Schwabdr et al. (2000) believes that the rapidly changing environment forces the organization to learn as a unit and spread the knowledge among its members.

In the first group, Senge et al. (1994) suggest that the learning organization is developed on the individual learning. When the individuals go through the deep learning cycle, they develop their conceptualization. This is the main factor making the learning organization different from traditional organization because the organization no longer relies on fragmentation, compromise, defensiveness and fear. In contrast, the development of the learning organization brings the organization to integrity, openness, commitment and collective intelligence unit.

The deep learning cycle as shown in Figure 2 consists of three main parts: (1) attitude and belief; (2) skill and capability; and (3) awareness and sensibility. Due to the diversified attitude and belief, the individual learning is different. It is challenging for managers to bring the aspiration to their employees. Moreover, the communication among organizational members is a significant key to leading to the agreement. These ideas are given to other organizational members, which are usually accepted as the methods or procedures. When the cycle continues through the guiding process, the ideas or knowledge are reviewed. However, the organization is in the open system so it has the environmental reflection. This is the input to the organizational members who share their thoughts and make their decision as well as doing the actions. Finally, the larger picture of the conclusion of organization's vision and theory would be found. The summarization of this process is shown in Figure 3. Therefore, in the first group, the most critical factor for the learning organization is that the organization needs to learn as individual and the knowledge developed through individual learning would bring the learning organization to the ends.

In the second group of learning organization model, Schwabdr and Mariad (2000) propose that the learning organization relies on information. As the organization gets information, there would be a filter to select these useful and applicable inputs to organization. The actions would be planned to transmit this information both in acting and reflecting. Finally, the pattern of reflecting would be kept as knowledge. This school of thought proposes that the organization learning model consists of two parts: focus - external and internal factors - and purpose (goal) - means and ends. Figure 4 summarizes the model of organization learning under Schwabdr et al. (2000).

Figure 2: Senge et al's Learning Organization Model
Schwandt et al. (2000) apply their learning organization model from general theory of action proposed by Parsons (1951). The theory of action suggests that organization is the combination of four main activities, namely, adaptation, goal attainment, integration and pattern maintenance. All these activities are the combination of actions, and their details are summarized below (Schwandt et al., 2000).

1. Adaptation aims to serve the establishment of relationships between the system and its external environment factors of "environmental interface". These activities mainly deal with the evaluation or internal and external data, e.g. customer feedback and employee survey.

2. Goal attainment serves to define the goals of the system and to mobilize and to manage resources and efforts to attain goals and gratification. Its major task is the evaluation of results and decision making processes.

3. Integration purposes to establish control, to inhibit deviant tendencies and to avoid serious disturbances. Its main job is the implementation of organizational roles, leadership process, structural manipulation and communication to lessen the dissemination and diffusion.
4. Pattern maintenance involves the accumulation and distribution of cooperation among organization's member. It is the supreme goal of organizational learning, in which the symbols, values and norms are created and maintained.

**IMPORTANCE OF CORPORATE GOVERNANCE**

The immense changes in the economic environment caused by globalization and technology have forced organizations from around the world to make significant transformations in order to adapt, to survive, and to succeed in the fast-moving world. The replacement of the technology and information era to the machine or industrial era has come along with the movement from the quality efforts, e.g. TQM (Total Quality Management) or JIT (Just in Time Management) in 1980s to the organization reengineering in 1990s. This leads to a more economical production cost; higher quality products; more services to meet customers' expectation; and eventually more customers' satisfaction.

The outcomes of changed environment that is present in late of 1990s are the endeavour of cutting overall costs and pushing the profit up. The terms of "reengineering", "restructuring" and "reorganizing" have become to be the manual of success accepted by managers. However, these terminologies fail to satisfy all stakeholders that organization deals with. The corporate governance concerns on stakeholders, which requires more than profitability. In the past, this normally is demanded by shareholders as the main goal. Stakeholders are not just capital owner (shareholders) but they are those individuals or groups who depend on the organization to fulfill their own goals and on whom, to return, the organization depends (Johnson and Scholes, 2002). Consequently, the existence of global standard as the requirement of "good corporate governance mechanism" spreads out through all levels, i.e. country and organization in this millennium.

Figure 5 demonstrates the effects of changed environment forcing the organization to become the learning organization. One of main goals of the learning is to implement and maintain the good corporate governance mechanism in the organization. It is necessary that the term "good" is used in stead of "efficient" corporate governance. This is because the corporate governance is difficult to measure and compare between its input and output. It also deals with many factors both on quantitative (objectivity) and qualitative (subjectivity) criteria. The judgement of objective reality is mainly based on rational rules of order while the consideration of subjective reality is relied on how individual interpret the meaning (Waldsee, 1997).

**Figure 5: Environment Change Leading to Requirement of Learning Organization**

- Period of 1980s
  - Quality Efforts (e.g. TQM, JIT)
  - Lower Production Cost

- Period of 1990s
  - Reengineering
  - Restructuring
  - Higher Profit Margin

- Period of 2000s
  - Good Corporate Governance Mechanism
  - Balance Requirement of Stakeholders
  - Learning Organization (LO)
CORPORATE GOVERNANCE MECHANISM

Corporate governance issues are truly interdisciplinary in nature, drawing heavily on the fields of economics, finance, law and management (Sloan, 2001). Since 1997, the financial crisis has forced Asian firms to pay more attention on the corporate governance issue (Dickinson and Mullineux, 2004). The corporate governance has become part of firms' missions or one of goals to be achieved. This is especially after the cases like Pricewater and World Communication companies cropped in early of 2000s. McGregor (2000) proposes that the recent upsurge in corporate governance studies is a result of a sense that compliance units are not sufficient to handle agency problems. Gompers et al (2001) investigated corporate governance and corporate performance in the U.S.A. and found a significant relationship between firm corporate governance mechanism efficiency and its stock returns to investors. They also found that weaker shareholder rights are associated with lower profits, lower sales growth, higher capital expenditures and more corporate acquisitions.

Although corporate governance is widely discussed lately, its issue has been studied for many years. The agency theory suggests a possible definition of corporate governance mechanism (Jehn, 2001). This is because agency theorists treat firms as contract sites between principals (the owners of the factors of production) and agents (those who manage these factors to create goods and services) (Jensen and Meckling, 1976). All the parties of contracts (agency relationships) are utility maximizers there is good reason to believe that the agents will not always act in the best interest of all principals (Jensen and Meckling, 1976). This is because agents who control corporate assets can use the assets for a range of purposes that are detrimental to the interests of financiers, such as wealth transfers from financiers to themselves and sub-optimal allocation of capital, as well as managerial perquisite returns (Bushman and Smith, 2001). These transactions, if carried out by controlling shareholders, would be at the expense of minority shareholders (Jensen and Meckling, 1976). Thus, the expropriation of minority shareholders means that insiders (managers and controlling shareholders) have the ability and desire to divert funds for their private benefit (Lev and Lins, 2001). The ability of managers to expropriate is directly related to their degree of "voting rights" while their desire is related to the consequences of their actions on "cash flow rights" obtained from the shareholders' firm. The separation of "voting rights" (control power) from "cash flow rights" (ownership) exacerbates controlling shareholders' incentives to exploit minority shareholders. The reason is that when voting rights and cash flow rights are not separated, controlling shareholders cannot externalize most of the expropriated costs. Thus, controlling shareholders would act as monitors who increase the value of the firm for other stakeholders (Lev and Lins, 2001).

Theoretically, laws are the most important factors to remedy principal-agent relationships. Corporate and other laws give outside investors, including shareholders, or managers certain power to protect their investment against expropriation by insiders. These powers in the case of shareholders range from the right to receive the same dividends per the insiders, to the right to vote on important corporate matters such as the election of directors or the right to sue the company for damage from their mistakes. While the management perspective proposes that principals can limit divergences from their interests by establishing appropriate incentives for agents and by incurring monitoring costs designed to limit the aberrant activities of agents (Jensen and Meckling, 1976), the benefits from monitoring activities depend on percentage of shares that shareholders have (Easterbrook and Fischel, 1983).
In Jensen and Meckling's original agency model (1976), the agency cost is equal to zero when a firm is owned solely by a single owner-manager. When management owns less than 100 percent of a firm's equity, shareholders incur agency costs resulting from management's shirking and perquisite payments. While the existence of agency costs reduces a firm's operating performance (Banz, 1981), firms managed by shareholders have significantly lower agency costs than those managed by outsiders (Ang et al., 2000). However, due to the limitations imposed by personal wealth constraints, exchange regulations on the minimum number of shareholders, and other considerations, no publicly traded firm is entirely owned by management. Thus, the agency costs are widespread through all public organizations.

Corporate governance has developed to satisfy the enforcement of specified rights and residual rights. Although specified rights are commonly enforced by contractual governance certified by laws, residual rights can only be enforced by corporate governance (Sloan, 2001). As an agreement, corporate governance is enforced only by relation or rule (Li, 1998). Relation-based governance is based on personal or implicit agreements while rule-based governance comes from the requirements of third parties, especially in relation to expropriation.

Tricker (1998) defines corporate governance mechanism as a combination of supervision and accountability. Supervision is the activity of monitoring and overseeing managerial performance while accountability is management's degree of responsibility to the firm's legitimate requirements. Its mechanism deals with the ways in which suppliers of finance to corporations assure themselves of getting returns on their investment. This involves: (1) assessing the risks associated with how firms use their financial resources; (2) evaluating how firms allocate capital for maximum returns; and (3) monitoring how firms administer capital over time (Rubach and Seborn, 1998). This is a straightforward agency perspective, or separation of ownership and control ( Hart, 1995 and Shleifer & Vishny, 1997). While the principle concern of corporate governance is the way that companies are directed and controlled, there are a number of agencies with a part to play in the system, such as laws, regulations, shareholders and public opinion (Cadbury, 1999). Rubach and Seborn (1998) define six major groups of participants in a governance mechanism. They are individuals, institutional investors, businesses, creditors, employees, and governments. These groups are actually the stakeholders of a corporate organization.

Figure 6 summarizes the relationship between the agency theory and corporate governance concept.

Figure 6: Agency Relationships and Corporate Governance

![Diagram showing agency relationships and corporate governance](Image)
Appropriate corporate governance mechanisms vary systematically across firms (Mak and Li, 2001) and mechanisms are significantly affected by the legal and regulatory systems of a given country (Frowse, 1995). There is evidence that the inadequacies of legal systems in many countries lead to weak corporate governance mechanism in an organization (Larson et al., 1998). A good corporate governance mechanism can reduce the costs associated with risks for capital providers. As the costs of risks are reduced, these structures can maximize the long-term value of the corporation (Jean, 2001). Monitoring and supervision can reduce agency costs. Thus, a good corporate governance mechanism must select the most capable managers and make them accountable to investors (Jean, 2001). An implementation of good corporate governance mechanism would increase the capabilities of firms to monitor and control effectively, and also improve the transparency of financial transactions.

Two factors that influence corporate governance mechanism are legal protection and large investors. Firstly, legal protection is the confirmation of contract enforcement, whether it is written agreement or not. This leads to the exercise of rights, such as the right to vote in elections for board members, and the right to vote on important corporate matters. There are laws related to corporate governance practices at both the national level (corporate laws) and the firm level (corporate bylaws, charter provisions and other rules). Nevertheless, the extent of legal protection for financiers differs enormously across countries. Legal protection consists of both the content of laws and the quality of its enforcement. Legal and judicial systems influence the promotion of efficiently functioning corporate mechanism in organization because they encourage the responsibility of the organization's members.

Secondly, large investors, such as "blockholders" and large creditors, provide funds to a firm but are not interested in taking it over. There is evidence in the empirical literature that institutional investors and other blockholders influence managerial behavior (Brickley et al., 1998 and 1994). However large investors, some of whom may be activist institutional investors, can affect managerial behavior through the board of directors, which has the authority to hire and fire top managers, or through threats to sell large blocks of shares if a firm fails to respond to corporate governance issues that investors view as critical. This is becoming a more significant factor for top managers (Burkart et al., 2000).

Figure 7 summarises the main influence factors on corporate governance mechanism.

Figure 7: Influence Factors of Corporate Governance Mechanism

1. Legal Protection
2. Institutional Investor
   (Blockholders & Creditors)

Stakeholders
Residual Right

Contractual Rights

Agent (Managers)

Good Corporate Governance Mechanism
ORGANIZATION AND CORPORATE GOVERNANCE

When the learning organization concept is applied to implement the good corporate governance mechanism, the first task is to set up a good knowledge management system. This is because it not only helps establish internal consensus and a competition mechanism, but also contributes to corporate competitiveness and adaptability in the face of rapid external changes.

The good corporate governance mechanism needs to be designed. This can be done only by collecting the expectation of all stakeholders. The code of conduct for good corporate governance is the framework of balancing all requirements. By its reference, organizations need to find what they should still need to learn; identify what they have already learned; and share what they have learned to achieve its goal.

The good corporate governance mechanism demands the participation of organization’s members. Any knowledge contained in the individual, to be useful to the organization must be transmitted through the organization, which is not necessary to be linear system or is not compulsory. The learning of individual on good corporate governance is the only way to achieve and maintain the knowledge system. Therefore, the individual can contribute to create the learning organization of good corporate governance by:

"Actively engaging in the examination of the worth of the organization to find out the location of the major value added activities and how to improve the values added with responsibility for the good corporate governance mechanism (Waldenae, 1997)."

"Bringing their best available knowledge to bear on corporate governance issues."

"Sharing or creating the knowledge that leads to the improvement of good corporate governance mechanism."

Learning Organization Framework
and its Implication on Corporate Governance

"Co-participating in the creation, transformation and maintenance of the knowledge forms of good corporate governance mechanism whether this knowledge is in the terms of symbols, values or norms.

The key factors consist of sharing responsibilities, opening communications and maintaining of learning environment, i.e. thinking and analyzing (Hong and Kuo, 1999). When learning cycle has proceeded with reviewed knowledge, the learning organization is the outcomes. To maintain good corporate governance as learning organization, the learning cycle needs to keep in a circular casual relationship as shown in Figure 8.

There are several factors inhibit the organization to become learning organization (Garven, 1997). They are: cognitions and preferences reflecting behavior held by individual, the response of whole organization and the feedback from reflection of organizational environment. Thus, general problems of the implication of the learning organization on corporate governance are: the neglect of intra-organizational phenomena, the lack of clarity with respect to knowledge sharing of the organization's members, the learning behavior of individual, the culture and climate of a learning organization, the influence of organizational size and the role of teamwork within the organization itself.
Figure 8: Learning Organization of Good Corporate Governance

CONCLUSION

Nowadays the learning of corporate governance issue is the consequence of problems emerged both at the macro level (i.e. Asian 1997 financial crisis) and micro level (e.g. Enron and World Communication Companies). Corporate organization can take the opportunity to learn from the incidents and aware of the consequence of lacking good corporate governance mechanism. When organization learning model is applied to create a learning organization with an aim to implement good corporate governance, it is beneficial to the viability of corporate organization in the long term.

Bibliography


