Executive Leadership and Governance

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1 INTRODUCTION

Corporate governance and executive leadership play a critical role in facilitating effective and judicious management that can aid the company in delivering long-term success. Corporate governance is defined as a “system that controls and directs companies” (Financial Reporting Council, 2016b). Corporate governance entails how a company is run on a daily basis and how it is able to consider stakeholder interests. Corporate governance and executive leadership is influenced by factors that reinforced institutional elements such as a stock of capital markets, personnel turnover, legal systems, and flexibility of labour markets (Evans et al., 2008). The United Kingdom follows the Anglo-Saxon legal tradition which forces corporate governance to focus on the firm’s shareholders (Filatotchev et al., 2007).

This model of corporate governance influences its interactions to be transactional, that is they are isolated from any institutional context. The shareholder model emphasises the strengths of the capital and labour markets as this is what is used to distribute resources throughout the firm. The model also relies on high-powered incentives and external control systems to keep the interests of executives in line. Firms operating in the UK also use the principles-based approach to corporate governance, the opposite of the ‘rules-based’ approach used in the United States. The principles-based approach is flexible in that it believes that a single set of rules is not applicable for every firm. The approach argues that situations can be different for every company and so it needs to cope in its own way. This approach to corporate governance influences the leadership styles in a firm, its risk management approach, organisational culture, and financial leadership. Since this approach is flexible it is often left to those in charge to interpret them.

The application of these approaches and the consequences are clearly seen in the case studies of NHS Trust Mid Staffordshire Hospital and Tesco’s accounting scandal. The current report will analyse the principle-based approach to corporate governance with regard to these case studies. The primary aim of the report is to critically evaluate and analyse both firms through a comparative lens of how they used these approaches and what the consequences were. The report will be structured as:

1. Evaluation of governance and risk management approaches used by Mid Staffordshire Hospital and Tesco.
2. Comparison of the firms’ approaches.

3. Analysis of regulations and regulators on both firms' situations.
4. Comparative analysis of each firm's leadership approach
5. Critical examination of each firm's board as a leader using evidence from case studies.

2 Corporate Governance & Leadership of Mid Staffordshire Hospital

A public inquiry published by Sir Robert Francis in 2013 shed light on the failings that occurred at Mid Stafford Hospital between 2005 and 2009. The report characterised the hospital as providing extremely poor quality of care under the management of the board that was entrusted with assisting the hospital-acquired the coveted Foundation Trust status.

Sir Francis's report revealed that the board was ineffective in its governance that translated to poor hospital performance. In 2004, Stafford Hospital's rating by the Commission for Health Improvement was reduced from three stars to zero (Smith and Chambers, 2019). Stafford Hospital was plagued with poor nursing and medical care, specifically for elderly patients, patients who were dying, and patients treated in the accident and emergency department over a long period of time (Smith & Chambers, 2019). The hospital staff lacked compassion for patients, were disengaged with the entire organisation, and there was a toxic work environment in which staff kept quiet for fear of getting in trouble (Smith & Chambers, 2019). With everything happening, the hospital board did not take corrective active measures to address the situations clearly showing that it did not have effective leadership and corporate governance skills.

An organisation's operations and performance are critically linked to various management factors, but corporate governance is imperative for direction and control. According to Manna et al. (2019), a weak corporate governance system is a primary reason that explains failures in most firms. That is because corporate governance is a decision making process and the ability of a firm to exercise power over a group of people (Alrowwad et al., 2017). Grace et al., (1995) and Garcia-Castro et al. (2008) argues, for a corporation to achieve sustainability and performance, it needs to reform and improve its corporate governance structure which cannot be ignored. Without a robust corporate governance system and leadership strategies, an organisation cannot effectively implement change. It is the duty of corporate leaders to integrate effective measures that in the long run foster the firm to grow to help it achieve its vision.

In the case of Mid Staffordshire, there were extensive failures on the board's corporate governance processes. This is because the board made its primary focus on achieving a financial bottom line for its shareholders at the costly expense of its stakeholders (i.e. patients, their families, Staffordshire wider community, and staff).

When analysing the situation at Mid Stafford, it was evident that the board was simply complying with the principles of corporate governance by letter and not in spirit. According to the UK Corporate Governance Code, one of the principles is '*leadership*', having "an effective board that is collectively responsible for the long-term success of the company" (The Financial Reporting Council, 2016b). Furthermore, the Financial Report Council (FRC) states the board and its committees should have "an appropriate balance of skills, experience, independence, and knowledge of the company" in order to conduct their duties and responsibilities effectively and efficiently (Financial Reporting Council, 2016b). There is no doubt that the chief executive officer appointed to Mid Stafford was competent, the executive team was competent, so were the NHS commissioners funding care, the senior doctors, universities and deaneries, local government scrutiny bodies, regulators, and even the Secretary of State for Health at the time.

But competency in an individual sense is not enough to help a sinking ship if collective effort under one vision is not implied. According to the report published by Sir Francis, the chief executive at Stafford experienced this role for the first time. It was not odd for a newcomer to take the mantle, however keeping in view the ailments of Stafford Hospital at the time, given its isolated area a more experienced individual would have done a better job. Sir Francis note that the executive team placed at the hospital did not prioritize patient care or frontline staff concerns. As for the board, they were more concerned with "Foundation Trust" status.

These ad hoc priorities had an adverse impact on the organisational culture of the hospital, making is a festering pool of bullying, patient endangerment, denying problems, blame culture, and keeping quiet. Evans et al. (2008) argue, organisational culture is a reflection of the shared and learned values, beliefs, and attitudes of all its members. Fostering a positive organisational culture is integral to employee engagement. Howell (2017) defines employee engagement as the extent to which an employee behaves in ways that represent high levels of commitment to their organisation. Howell (2017) argues engagement does not just mean making them happier, but bringing out the best in people, this means managers and employees need to have a good relationship; with managers acting as leaders. For Mid Stafford there was very little employment engagement which contributed to the deteriorating organisational culture of the firm.

Cheng, Wei, and Lin (2019) argue that responsible leadership flows down the organisational hierarchy and reduces unethical pro-organisational behaviour. A study conducted by Constandt and Willem (2018) furthers this argument through their study of understanding the trickle-down effect of ethical leadership in the context of a non-profit football club. The study concluded that the influence of board ethical leadership trickles down to football players through their coaches' ethical leadership. Hence, for the sake of argument, we can generalise that the ethical leadership of a board impacts the ethical climate of an organisation and its culture. In the case of Stafford Hospital, the board was not acting ethically because they preferred financial profits over patient care which seeped into its organisational culture.

Mid Stafford Hospital's dangerous organisational culture developed over time despite warning signals that were evident for the board to discern. It is the responsibility of organisational leaders like the board to ensure that organisational culture is parallel to changes from internal and external stakeholders (Asif et al., 2019). This insight reduces the decline in organisational performance. For Stafford Hospital, the board clearly ignored the expectations of patients and their families (i.e. external stakeholders) which was translated into the declined quality of patient care. The board was well aware of these issues but they refused to take proactive measures to handle the situation.

3 Corporate Governance & Leadership of Tesco

Like all firms in the UK, Tesco plc operates using the principle-based approach to corporate governance, with a shareholder approach. The UK's Corporate Governance Code ('The Code') is an integral part of the Company Law the defines a set of principles recommended as good corporate governance for companies that are listed in the London Stock Exchange (Arcot and Bruno, 2006). It should be noted that Listing Rules derived from the Financial Conduct Authority are given statutory authority under the Financial Services and Markets Act 2000 (Financial Services and Markets Act 2000). This makes it a requirement for public listed companies like Tesco to disclose to shareholders how they have complied with the code, and if they haven't then provide a genuine explanation as to why.

This is known as the comply and explain the approach. Companies need to comply with corporate governance practices and if they do not, they simply explain why they haven't in their report to shareholders. The Code is not a rigid set of rules but is "best practices" that consist of principles and provisions (Financial Reporting Council, 2016b). The Listing Rules make is mandatory for companies to apply the Main Principles of The Code and report to shareholders how they have integrated it. If companies do not comply with The Code they can justify its nonexistence by providing the rationale for their circumstances and alternatives if good governance can be achieved by other methods (Financial Reporting Council, 2016b). Departures from The Code are not considered breaches.

Tesco Plc, complied with the letter rather than the spirit of good governance requirements particularly looking at the case of the financial misstatement debacle. According to The Code, the board did establish formal and transparent arrangements when establishing an audit committee (Financial Reporting Council, 2016b). The board also satisfied The Code by having one member of the audit committee has recent and relevant financial experience. The Audit Committee did monitor the integrity of the financial statements of the company, it reviewed the company's internal financial controls, and it did make recommendations to the board. PwC also pinpointed that the practices raised concerns about the possible improprieties of financial matters.

However, Tesco did not follow the spirit of The Code. They made failing attempts to control the misstatements but did not stop the fraud from happening altogether. Evidence of this begins with the then CFO Laurie Mcllwee sending an e-mail out, warning employees that misstated financials were a transgression (Kukreja and Gupta, 2016). However, there was no follow up to ensure that employees were compiling with company policy. Tesco's corporate governance approach was in shambles, this is evident from the lack of communication between the financial department and other departments.

The financial department of the company believed that full disclosure of documentation was not being provided, which caused the 'whistle blower' to seek the remedy of the situation by approaching the company's legal department to bring it to the attention of the new CEO Dave Lewis (Kukreja and Gupta, 2016). One thing that Tesco's new CEO got right was assessing the situation and making a statement of the overstatement of profits. The new CEO looked to be adamant in fixing the corporate governance issues of Tesco, and reporting on the issue triggered an investigation but it may have shown shareholders that the changed leadership is willing to do the work to put the company back on track.

A concerning matter in the case study was the auditing firm PwC. From 2013 to 2014, PwC in their year-end audit raised concerns about '*Commercial Income Accounting'*, the auditors would go on to raise this concern three times but Tesco's auditing committee believed that this area was not a matter of concern (Kukreja and Gupta, 2016). This goes to show that although the committee may have had competent people, they were not well versed in managerial finance if that was the decision they concluded. Further investigation into the debacle shows that PwC were an auditor for Tesco for over thirty years (Kukreja and Gupta, 2016).

A long relationship between firms like this may have muddied the waters of the auditor's objectivity. It is highly likely that PwC's independence on the matter was comprised of such a long relationship with Tesco. George (2004) argues that long-term relationships between auditors and their clients may impair the auditor's independence and professional scepticism that is needed and rotating auditors may act as a counter to this perception. He, Kothari, Xiao, and Zuo (2018) argue that an auditor's willingness to challenge their clients is the essential factor that deters corporate fraud. There is a possibility that the long term relationship between Tesco and PwC may have hindered both to take action necessary action to stop the fraud from occurring in the first place.

The root cause of the entire fiasco is the high-pressure sales tactics that were placed on employees. The senior staff at Tesco was greatly incentivised if they met their targets and the structure of the incentives programme motivated these employees to manipulate the figures to meet the targets. It should be noted that sales incentives and vendor allowances are common in the sectors that Tesco operates in by giving retailers and other customers various kinds of vendor allowances. But in the case of Tesco, buyers were regularly asked to look for additional income that can be brought forward causing the company to manipulate figures to enhance income and meet targets (Kukreja & Gupta, 2016).

4 Comparative Analysis of Tesco and Mid Staffordshire Hospital

4.1 Organisations' Approach to Risk Management

Sir Robert Francis indicates in his report indicates that Mid Staffordshire Hospital was largely compliant with standards regulated by the Healthcare Commission (HCC) and it was rated by the NHS Litigation Authority (NHSLA) for its risk management. On close inspection of Mid Staffordshire Hospital, it was evident that the organisation had implemented the Risk Management Framework because all NHS hospitals are required to do so (NHS Resolutions, 2020). According to NHS Resolution (2020) the entire NHS organisational structure, regardless of care centre, is supported by the Risk Management Framework. The core belief for this structuring is rooted in monitoring and addressing strategic risks that would prevent an organisation from achieving its aims and business objectives. By using the Risk Management Framework, hospitals like Stafford can set methods for mitigating risks and have sources that assure the controls are effective.

The organisation believes that risks are linked to objectives and strategic aims that are evident at all levels of the organisation. These are defined as – strategic risks, corporate operational risks, team risks, and programme and project outcomes. To ensure the implementation of the risk policy, the corporate governance team is responsible for integrating the policy and procedure. The duty of the Directors, Deputy Directors, and Heads of Services is to cogitate the risk management processes and risk register on a quarterly review. These are then reported to senior management teams and an internal audit can take place if it is required.

As for Tesco, it has operated on an Enterprise Risk Management (ERM) system due to the nature of its business. According to COSO (2004), ERM is defined as a process that is impacted by a firm's board of directors, management and all personnel, which is applied as a form of strategy setting throughout the enterprise. COSO (2004) further details, that ERM is designed to identify potential events that may have an impact on the firm and it manages risk to be within the limits of its risk appetite, as they give enough assurances with regards to achieving the firm's objectives. To ensure that Tesco's governance body is able to meet its performance goals while complimenting risk management controls, the company uses a strategic risk management control loop (Woods, 2008).

The control includes risk assessment, reporting and response. The corporate strategy and the risk strategy are determined by the Board of Directors who define what the maximum level of accepted risk is. The line managers are responsible for an internal audit to establish a list of risks that can be experienced across all business and designing controls, as determined by the adequacy levels established by the Board of Directors (Woods, 2008). To determine how effective these controls can be at each business unit, performance is monitored by line managers and the CEO of each business unit is responsible for the risk performance.

The risk management process at Tesco is undertaken all through the hierarchy by maintaining a Group Risk Register. Each of the various units in the business is required to conduct regular assessments of risks, particularly in operations and local market risks. Tesco understands that some of the main risks include customer proposition risk, uncertainty from a transformational economic model, changing competitive landscape, and liquidity risk. To better understand and mitigate these risks, the company has formulated minimisation strategies that are evaluated using the Risk Threshold Probability. Some strategies may not be effective in influencing the operations of the company while others may have a significant impact.

4.2 Commonalities in Tesco and Mid Stafford's Approaches

Both companies had committed fraud to some extent with their flawed corporate governance approaches. It is apparent that both organisations had executives on governance roles who either did not notice what happening or if they did, they simply failed to act thus avoiding their core responsibilities. Both are dangerous situations. This indicates that both company's corporate governance systems were not developed to ensure competent people would lead the company. For Tesco, the executives and top management were already making severe mistakes with expanding the company into operations sectors that drove away from its primary business of being a grocer.

The company sustained billions in losses by expanding operations into the United States without taking into account local consumer tastes and behaviours. This shows that whoever was in the corner office making decisions, definitely did not know what they were doing. This is witnessed again when both organisations appoint executives on committees that lack the industry knowledge, business knowledge, and best business practices to deal with the situation at hand. Tesco did so by having members on the audit committee that lack expertise on financial matters. Stafford Hospital did this by appointing a board that placed financial gains even if it meant patients were put at risk.

Both organisations had developed a poor culture that seeped down from their board members and top management. Stafford Hospital had a terrible culture of blame, a toxic work environment, and no concern for the patient. This led to four deaths that were easily preventable. Tesco had created a culture of misstatement and inflation of financial reporting through their aggressive incentive scheme that motivated individuals to bolster financial statements. It's obvious that both companies were lacking in experts with financial know-how.

Without an expert that can clearly direct a company's finances, organisations end up stooping to these conducts. There was a clear lack of a financial leader in the company in the form of a CFO. Tesco remedied that by hiring Alan Stewart to take over. On the other hand, Stafford Hospital was able to hire Aaron Cummins as the Finance Director. Both these individuals have the passion and the drive to better steer their organisations in a healthier financial direction. They will play an imperative role to fix the corporate governance cultures of both organisations.

Each of these cases baffles the mind because both organisations have their own risk management system in place. It is designed to ensure that risks are identified early and are remedied or mitigated. Yet, both organisations were ineffective in managing their risks. On both sides, executives ignored the issues, either turning a blind eye or not having the knowledge to act.

4.3 Impact of Regulations on Governance

In the case of Mid Stafford, regulations and regulators were one of the driving factors that caused the organisation to lose touch with its core business values, drove financial incentives over patient care, and resulted in the loss of precious human life. The board's primary focus was to obtain a "Foundation Trust" status that was driven by maintaining strict regulations and complying with regulator standards as defined by The Monitor. The reason this spiralled out of control was that Stafford was already suffering from poor performance. In areas where the Trust is performing well, then external regulation systems are tolerable.

However, if the hospital is already in turmoil then external interventions like performance management create a warped mindset that shifts focus away from quality measures. The oversight methods of the NHS Trust already have too many standards and information requests which causes confusion for employees to discern which of them are minimum standards and which are aspirational. Increasing regulations on Mid Stafford to force into the category of “Foundations Trust” further hindered the situation to such an extent that people’s lives were lost. For the public sector, having regulations and external regulators improves performance if it is applied while taking an organisation’s precarious situation into account.

Many experts within capitalist’s societies and markets believe that the less regulation the better environment for the market. Personally, regulations and regulators when applied specifically can actually help a market thrive and can be beneficial while also minimising the risks for other stakeholders. For example, Tesco had PwC as an auditor for over thirty years. Had there been statutory remedies or regulations that insisted that auditors be rotated after an *x* amount of time, maybe the turn of events for Tesco would have been different. This regulation is found in the Sarbanes-Oxley Act in the United States. Regulation is a tool that can be used to address market failures.

Marketing regulations in the UK and across other Western capitalist markets have curved monopolies from forming, ensured fair competition, and stopped anti-trust activities. Having regulations in both the private and public sectors will ensure stability and integrity to protect consumers, maintain standards, and ensure a levelled playing field for businesses to compete. A perfect balance needs to be achieved between government-driven solutions and market-driven solutions. A completely free market with no interventions would turn into the wild west of yesteryears when Britain had stepped into the Industrial Revolution and practised *laissez-faire* economics.

5 Leadership Capabilities

Having social awareness is one of the fundamental aspects of an organisation’s journey to achieving long-term sustainability. For researchers like Howlader et al. (2018) emotional intelligence is the foundation with which corporate social awareness can be formed. When organisations are lacking in leaders with emotional intelligence, the firm is unable to develop and sustain a positive corporate reputation. Emotional intelligence in leaders is also linked to improving the productivity and morale tone of employees when executing their responsibilities (Dappa et al., 2019).

Top et al. (2020) argues that organisations can learn to develop and strengthen their level of emotional intelligence to the benefit of the firm across all levels. On the contrary, Lewis et al. (2017) assert that this can only be achieved if organisational leaders are aware of their followers' emotions. This makes it imperative that organisational leaders develop and deploy effective internal communication strategies, have a high level of emotional intelligence, and be effective in influencing their team members. Asif et al. (2019) add-in that organisational leaders that aim for change and improvement should foster a positive team ethos by igniting the passions of members and driving the use of positive emotions.

Mid Staffordshire Hospital Board and its executives had completely ignored the importance of having leaders with strong emotional intelligence. It was obvious that the board's agenda did not include developing an environment favourable positive working. The needs and emotions of staff members were completely ignored and instead the board had ended up making a hostile work environment. This also had a negative impact on the organisational culture. The inquiry into the hospital found that poor to no leadership was in place within the organisation. The hospital staff was left without a supportive work environment but was festered with an air of fear. Staff members were unable to speak up about their environment or the policies of the board for fear of retaliation from the organisation's management.

When studying the case of Mid Staffordshire, it is obvious that the Chief Executive of the hospital did not adequately play his role. Also, the hospital board did not act as transformational leaders. They were authoritative in every way – policy-making, risk management, lacked empathy, which resulted in poor quality of service. The board's rigidity and authoritative style of leadership and governance resulted in a conflict of values between the board and its employees. Lewis et al., (2017) argue that organisational leaders should focus on incorporating an effective leadership style to nurture a positive organisational culture.

Transformational leadership was severely needed within the Mid Staffordshire board to foster a culture of transparency, ethics, and produce a collaborative management approach in the organisation. Hall (2019) argues that transformational leaders are collaborative, this gives way to transparency using an interpersonal exchange. The end goal of transformational leadership is to create valuable and positive change in followers which helps them convert into leaders (Grace et al., 1995). A study conducted by Dappa, Bhattie, and Aljarah (2019) found a positive relationship between transformational leadership and employee satisfaction. The study further found that perceived organisational politics and organisational commitment mediated the relationship between transformational leadership and employee satisfaction (Dappa et al., 2019). Greater organisational commitment, and decreased perception of organisational politics, positively impacts the relationship between transformational leadership and employee satisfaction. Hence, this generalisation can be used to improve the situation of Mid Stafford.

In comparison with Tesco, Tesco's leadership before the entrance of Dave Lewis was mostly transactional. Both previous CEOs had valued order and structure. They were also insiders of Tesco and most likely enacted the incentive programmes to promote compliance of their followers using rewards and punishments. However, Dave Lewis seems more like a person that leans towards transformational leadership. He began his journey in the midst of an accounting fraud scandal but was adamant to learn from the front-line workers in order to incorporate policies that would ensure that Tesco jumped back from crisis.

According to Eley (2020), Dave Lewis centred around asking questions and listening to colleagues that already knew the business – look and listen. By using this approach, Lewis was able to analyse the situation, understand the issues in a direct manner by taking the board out of their office and into the stores. According to Willem (2018) to develop a strong organisational culture it is imperative to integrate employees into the decision-making process and establish effective internal communication. Lewis was using this approach to build back the trust of bottom-line employees towards management and also build that trust up again for consumers.

Both organisations can use transformational leadership style to reassess business objectives and work on ethical issues in the organisations at different levels. According to Cheng et al. (2019), ethical issues in a firm can take place on the organisational, personal, societal, and international levels. Mid Stafford and Tesco had ethical issues at the personal level, where performance was based on financial metrics forcing the staff to go to any means to achieve these goals without taking into consideration the ethical ramifications. This personal level of ethics was influenced by ethics on an organisational level. Tesco's aggressive incentive policy and unrealistic financial goals were an underlying cause of pushing staff towards unethical practices.

For Stafford Hospital, it was the Board's complete ignorance of patient care that reverberated throughout the hierarchy. The staff at the hospital did not make it a priority to offer a high level of excellence in executing their responsibilities. It is obvious that Stafford's board was not concerned with the staff's personal development causing a loss of moral and ethical sensitivity. Tesco's leader Dave Lewis reinjected ethics by firmly acknowledging the accounting scandal. He did not shy away from pointing out the company's mistake. He stated, "we paid [the fine] because we were guilty" (Eley, 2020). Acknowledging this transgression from the seat of the CEO, trickles down the sentiment and teaches employees that it's important to own your mistakes and make a plan to fix them.

6 CONCLUSION

Corporate governance is the backbone in which any organisation can operate in. For companies and organisations operating in the UK, the primary approach used is the shareholder approach and corporate governance is incorporated using the principles-based approach. This is commonly found throughout capitalist markets under the Anglo-Saxon tradition. The report presented above examines corporate governance and leadership using the case studies of Tesco plc's accounting scandal and NHS Trust Mid Staffordshire hospital scandal. Both companies had faced adverse circumstances due to their significant lacking ineffective corporate governance policies.

It is concluded from the report that both organisations use the context of The Code to fill minimum requirements of corporate governance without truly fulfilling its core conditions. The organisations discussed were more interested in financial values than caring for their consumer basis, the larger community where they operated, or their own reputations. The cause identified for this lacking is rooted in a weak system of governance and weak leadership on the board. Using evidence from peer-reviewed academic literature, it is found that transformational leadership can have a significant impact in improving Tesco's and Mid Stafford Hospital's organisational culture, company-wide performance, improve ethical stance, and eventually improve its financial condition.

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