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Corporate Governance: The Role of Management and Other Stakeholders in Good Governance

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ABSTRACT

The wealth and success of organizations has largely been attributed to the influence of the shareholders' financial contribution, and their capacities to shape the future of the company they invest. This assertion subscribes to the traditional corporate law principles that companies must focus on protecting the ownership (shareholders) by establishing mechanisms for wealth maximization. Interests that favour the stakeholder groups such as employees, creditors, vendors, customers, government, or other regulatory agencies are generally construed as the means of protecting the shareholders, or effort to boost the ego of the management. Many scholars have argued that the interests of the stakeholders can be understood as constraining factors inhibiting the rights to maximize the owners' wealth. This paper seeks to establish the compatibility that exists between the shareholders and stakeholders, not as rivals but as partners in progress towards maintaining organization's sustained growth and high productivity. It further clarifies the roles of stakeholders, and how their interests could impact on the company.

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Abstract

The wealth and success of organizations has largely been attributed to the influence of the shareholders' financial contribution, and their capacities to shape the future of the company they invest. This assertion subscribes to the traditional corporate law principles that companies must focus on protecting the ownership (shareholders) by establishing mechanisms for wealth maximization. Interests that favour the stakeholder groups such as employees, creditors, vendors, customers, government, or other regulatory agencies are generally construed as the means of protecting the shareholders, or effort to boost the ego of the management. Many scholars have argued that the interests of the stakeholders can be understood as constraining factors inhibiting the rights to maximize the owners' wealth. This paper seeks to establish the compatibility that exists between the shareholders and stakeholders, not as rivals but as partners in progress towards maintaining organization's sustained growth and high productivity. It further clarifies the roles of stakeholders, and how their interests could impact on the company.

Who are the stakeholders and what are their interests?

The concept of stakeholders has been variously defined, but the definition provided by OECD crystalizes the roles of stakeholder as critical unit with controlling interests in organizations they represent or identified. The actual meaning of stakeholder first appeared in the management literature in an internal memorandum at the Stanford Research Institute (now SRI International Inc.), in 1963.[1] The term was meant to generalize the notion of stockholder as the only group to whom management needs responsive. Thus, the stakeholder concept was originally defined as "those groups without whose support the organization would cease to exist."[2] 'Something is 'at

[1] Freeman, Edward.R., The Stakeholder Concept and Strategic Management (pg. 31)

[2] Freeman, Edward.R., The Stakeholder Concept and Strategic Management (pg. 31)

stake' if it is at risk; one has a stake in something if one is materially concerned in its outcome.'[3] Stakeholders consist of boards, employees, suppliers, creditors, customers, competitors, community government, and society at large. These interest groups relate to the company through the nexus of contracts and obligations to the shareholders.

The stakeholder perspective ensures the objective of maximizing sustainable organizational wealth through effective optimization of the various relationships.[4] It is high time to consider other areas of human lives that could also benefits the customers they serve. Board of Directors have embarked on alternative strategy of corporate social responsibility. The rationale is that corporations are also vested with social obligations to perform their activities within existing legal frameworks and in the most ethical and socially acceptable way.[5] Stakeholder of various groups have wider interests that if properly aligned with the shareholders could substantially improve productivity, creates repeat customers and increased the revenue. What are these interests? I would start by considering the interests of the group that constitute primary stakeholders then moved on to the secondary stakeholders.

Board of Directors: they represent the interests of the shareholders by laying strategic direction, upholding corporate governance and setting the objectives for the executives. Their duties also include hiring executives; reviewing and endorsed the financials before publicized; Board of directors also have the obligations to the government and auditors. One of the famous regulations in Sarbanes and Oxley (SOX 302 and 404) require the executives and the board to certify the transparency of the internal control processes and the integrity of financial statements. These enormous responsibilities would ensure interests of the shareholders are protected. In many cases, members of the board must work concertedly to align the objective of the shareholders with the stakeholders in a perfect balance.

Management: In the theory of agency, stewardship, and stakeholders, these members of the company represent the voice of the board and of shareholders. They are the 'foot soldiers' saddled with the responsibilities of supervising the operational activities of the employees. The productivity and profitability of the enterprise generally relies on their capacities to coordinate all departmental resources with other internal and external stakeholders. Building and maintaining relationships are critical skills to harnessing mental and physical resources towards creating a sustainable growth and prosperous organization. [6]Evan and Freeman argued that managers have an additional duty of maintaining the health of the company by keeping stakeholder demands aligned with the investors' interests. In return, management expects the board to create an enabling

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[3] Yeo, V.CS., "The Role of Boards and Stakeholders in Corporate Governance" http://www.ecseonline.com/PDF/Role_of_Stakeholders_in_CorpGov.pdf accessed 01112016

[4] Mallin C.A., Corporate Governance (Fourth edition) (pg. 33-47)

[5] ibid

[6] Child J., & Marcoux, A. Freeman and Evan: Stakeholder Theory in the Original Position (Apr., 1999), 'https://www.jstor.org/stable/3857472?seq=1#page_scan_tab_contents' >> accessed 01112016

environment where they are handsomely compensated and assured of continuity. As members of governing council, Directors' role in corporate governance can be found in their duties and responsibilities which in turn, could lead to accountability and transparency.

Duties of skill, care and intelligence. Certain level of skills and expertise are required to represent the interest of the owners of company, and to meet all expectations of both the internal and external stakeholders.

Fiduciary duties. By the power and authorities vested on the Directors, they have certain control over the assets of the company. Therefore, they have the obligations to act in good faith, and in the best interests of the company. Directors must fetter their discretion and avoid conflicts of interests. Finally, Directors must always act in 'good faith' for the company and in the interests of the company they represent.

Employees: Arguably, employees are considered the primary stakeholders. They are contractually bound to offer their services, and in return, received compensation. Their interests are manifold. They want fair wages, career growth, happy workplace and a secure future. Their impact as coordinated workforce, charged with the responsibilities of carrying out operational activities ensured improved competitive advantages and increased bottom line. By so doing, the objective of the company's owners is being attained in mutually beneficial manner. It is of note that ordinary employees have no agency relationship with the shareholders rather, their position can be likened to that of a messenger, who delivers messages as sent by the owner. While managers act on behalf of the company in making critical decisions, employees are generally unbounded by the interests of the shareholders.

The involvement of employees in corporate governance spread across global companies, the significant of which cannot be understated. For example, the right to consultation. Certain management decisions require employees' input, and by subscribing to the opinion of employees, it increases the transparency and the entire management decision making process and enables the opinion of employees to invalidate the uneven information between the management and public. In another case, the right to participate in the board voting process also empowers employees to nominate their person of interest. It is not unusual to see members of the workforce on the board. This helps create a transparent system between management and board, which could be viewed as open process and greater fairness.

Creditors: the rights of creditors are largely protected by the contractual agreement with the company. In some cases, liens are placed on company's assets as a way of ensuring prompt payment of loans. Indirectly, this group are seldom treated as part owner of the company at least for the period of loan. Creditors are interested in the financial performance of the company, the transparency and accountability even before credit facilities can be extended. These components of governance ensure loan are serviced as agreed. The history of operations and customers' base could also be considered at the time of extending credit facilities.

Customers: organizations may not exist without the participation of customers - the group of stakeholders that often determine the realization of shareholders' interests. The influence of customers in the modern history, has shifted from the buyers of goods or subscriber of services to the influencer of goodwill. Customers could force companies to enforce certain cause they hold dear or implement some regulations. Call it customers' power, their abilities to influence are enormous. Besides using their buying strength to effect good governance, their satisfaction is also important. In the global marketplace with ever-changing customer needs and the surge of competitors, it is critical that the interest of customers be factored into the whole organization's corporate governance. Good customer service, customer feedback and quality products at a competitive rate would go a long way to making customers happy.

Government and regulatory agencies: many of the stakeholders discussed so far have been focused on internal structure, but companies are also governed by certain laws like, Company Act, 2006 in UK. This law governs the behavior of corporations with regards to its operational activities – environmental protection, fair compensation, employees 'rights, taxation, and financial disclosure. The interest of company's owners and primary stakeholders must observe the requirement of government as an external stakeholder to avoid undue interference, or business discontinuity.

Community: The last but important external member of the stakeholder group is the community where the company operates. The role of organization in the community has become more of partners in progress rather than 'greedy corporate big-wig.' In the interest of organization, and shareholders, this category of stakeholder require a careful attention and ongoing collaboration. The ongoing public unrest in Niger-Delta, Nigeria against the big Oil companies is a testament to how peaceful co-existence could suddenly become a fragile relationship. Corporate social responsibilities are the mechanism through which company seek to meet the needs and interests of the company, while simultaneously protecting their investors' objective.

Role of Stakeholders in Corporate Governance

Stakeholders' theory argues in favour of effective optimization of the various stakeholders' relationship as a strategy for maximising sustainable organisational wealth.[7] Managing the interests of all stakeholders could foster a positive outcome and peaceful relationship, but at what cost? [8]Sternberg, in her paper titled 'The Stakeholder concept: A Mistaken Doctrine,' denounced this theory as incompatible with business. According to the stakeholder's theory, organization should not be run for the benefit of any one group of stakeholders, with other stakeholders benefiting only incidentally if at all. Rather organizations should be run for the benefit of all stakeholders, whoever and whatever they may be. This doctrine contradicts the basic principle of

[7] Mallin C.A., Corporate Governance (Fourth edition) (pg. 34)

[8] Sternberg, E., The Stakeholder concept: A Mistaken Doctrine (Published November, 1999)

business of reducing overhead costs to maximize profits thus, creates wealth for the shareholders. To find a common ground towards good corporate governance, shareholders should inculcate the interests of the stakeholders alongside their own interests.

Stewardship theory took a different approach at governance by giving autonomous power to managers to act independently, but in the interest of the owners. It is valid that governance requires forming a strategic relationship among the stakeholders but satisfying all parties may be a tough thing to achieve. Amid divergent interests and different levels of stakes, the principal interest of the company's owners may be jeopardized. Managers can work with various interest groups to understand their specific interests and work creatively with the company's owners to address the stakeholders' interests in the best way possible yet, without sacrificing the fundamental objective of the stakeholders.

Over time, organizations have resolved that no single theory can satisfactorily produce a good corporate governance, giving a rise to the involvement of government in creating a central platform through which a company can achieve a good corporate governance. [9]The Combined Code represents the three reports (Cadbury Report, 1992; Greenbury Report, 1995; Hampel Report, 1998) stating that board should have sound systems of internal controls that are annually reviewed and reported to shareholders. The performance of an organization is largely dependent on its internal processes. Companies like Enron, WorldCom, Pamlat, Nortel Networks, and many others have experienced the outcome of the lack of sound internal control systems. This provides a golden opportunity for stakeholders to work together towards enforcing a sound internal control. Critical areas like finance, human resources, and procurement should be reviewed for potential segregation of duties' violations. In Canada, C-SOX (Bill 198) is modelled after US-SOX to ensure effective internal control, resulting in good corporate governance.

[10]The UK Stewardship Code (2010) aims to promote the long-term success of companies in such a way that the ultimate providers of capital also prosper. Effective stewardship benefits companies, investors and the economy. This code is directed to institutional investors and asset managers with the mandate of disclosing the sale of assets and other financials that might help in the accountability and transparency of the traded organization.

[11]UK Corporate Governance Code replaced the Combined Code, and quickly gained popularity through its principle of 'comply or explain.' This code identify steps organizations must run through to achieve a good corporate governance and required organizations that failed to comply to explain the reason for non-compliance. It brings governance to the door step the shareholders and stakeholder by requesting full compliance with the code. This is an opportunity for the

[9] Mallin C.A., Corporate Governance (Fourth edition) (pg. 33-47)

[10]Financial Reporting Council (2012), The UK Stewardship Code 'https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Stewardship-Code-September-2012.pdf' >>accessed 01112016

[11]Mallin C.A., Corporate Governance (Fourth edition) (pg. 33-47)

Directors to make the bold move by requesting the concerned stakeholders to work together towards achieving the requirements of the UK Corporate Governance code.

Role of Stakeholders in Corporate Governance

The critical role that plays in corporate governance cannot be understated. Various inter-operational activities and strategic initiatives require the expertise, skills, judgment and experience of highly capable stakeholders. Directors are the custodian of information and financial assets therefore, tasked with responsible behavior. By ensuring all levels of internal stakeholders understand their role in governance, and by implementing mechanisms that ensures transparency and accountability, Directors can protect the interests of the investors. Employees are the agents of change. Regular employees are tasked with completing their portion of internal control, separation of duties, data ownership and technology-business alignment to reduce the inherent control issues that could impact on the integrity of financial statement. Government and other regulatory agencies are tasked with keeping the organization in check towards achieving its goal of good corporate governance. Organizations cannot blindside the importance of community participation in the corporate governance. The community investment through sponsorship and project-specific initiative should be prioritized as a critical part of corporate governance.

Conclusion

Corporate Governance is the concept that concerns itself with balancing authorities and power between the shareholders and stakeholders for the primary benefit of maximizing wealth for the investors, while ensuring compensation for the stakeholders. This paper has carefully analyzed the essential role of each stakeholder within the corporate sphere, and the required level of participation to achieve a good governance. It is important for the management to coordinate with all stakeholders by empowering them to work together and cohesively towards high productivity, efficient resource allocation, transparency, sound internal controls and accountability. Several codes have been introduced including the UK Combined Code that later became UK Corporate Governance Code. The effort of the UK Government is to ensure organizations comply or explain the reason for non-compliance. This effort continues to be lauded as steps toward the right direction. That said, the inclusion of the inclusion of the stakeholders in corporate governance might just the prudent thing to do.