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CORPORATE GOVERNANCE AND STAKEHOLDERS' ACCOUNTABILITY

Theoretical article

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Abstract

Corporate governance is the system through which companies are directed and controlled but until today academic environment, regulators, corporations couldn't reach a unanimous definition. Corporate governance provisions suffered changes after several largely covered financial scandals. Entities incur costs when complying with new regulations but not complying impacts the reputation and investors might think twice before bringing their money into the company. Accountability for business decisions, risk management, control that set the economic path of the company is mandatory for proving that the company is run in a fairly and smart way. This study aims to investigate how corporate governance relates to accountability of all parties involved in the current business of companies as any conflict of interest is detrimental to the company and affects in a negative way its performance.

1. INTRODUCTION

Corporate Governance is a subject well debated by academic environment, by regulators and by companies. Why this interest? Mainly because of the capital (economic, human, social, cultural, natural) involved where debate of corporate governance arises. A definition of the concept accepted by all parties was not yet delivered as some see in corporate governance the mechanisms that provide investors a reassurance that they will get profit out of their investment, and others consider corporate governance responsible with the accountability of decision makers. Corporate governance has developed and evolved alongside with joint stock companies. Since the early stages of joint stock companies in the 19th century the history has seen corporate governance changing through political and economic struggle, and fighting the echoes of great financial scandals like South Sea Bubble (1720) till recently World Com (2002), Lehman Brothers (2008), CIT Group (2009).

In recent times the interest raised by corporate governance can be linked with following reasons in the opinion of Rampersad& Hussain (2014):

- The need for the public to be informed, educated, to understand and promote the essential corporate governance principles.
- To offer the board of directors and the management with suitable powers in fulfilling clearly formulated responsibilities so that they stand accountable to the shareholders in the search for operational and financial performance of the company.
- To provide the most suitable non-executive company directors in regard of background and experience.
- To face concerns of maintaining continuity of management through succession planning, identifying opportunities, facing challenges, and managing change with the business and appropriate allocation of resources.
- Corporations and regulators to work together in order to frame internationally accepted accounting principles, standards of financial disclosure, antitrust laws, bankruptcy laws that could meet up all stakeholders needs.
- To reach an equilibrium between economic and social goals or between the objectives of the individuals and those of the group by optimizing communication, fairness, disclosure, transparency, business ethics, and social responsibility.
- In the search for investors corporations should bring credibility to their business by implementing willingly corporate governance codes, by building reliable management structures, taking initiative to prove strong ethic values in entities that don't wait for outside interventions in order to comply with laws and regulations.

2. CORPORATE GOVERNANCE: TOWARDS AN INTEGRATED CONCEPTUAL FRAMEWORK

Numerous definitions were given to corporate governance without reaching the one that could be unanimously accepted. When requested to describe in a few words the concept, corporate governance can be defined as a system by which companies are directed and controlled in the interests of shareholders and other stakeholders.

Shleifer &Vishny (1997) analyse in their article "A Survey of Corporate Governance" the importance of legal protection of investors and the ownership concentration in corporate governance systems around the world concluding that "corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return of their investment".

So the discussion about corporate governance starts with company – ownership – control. Shareholders have the ownership of the company but usually play a passive role in the every-day life of the company because they delegate control of the company to qualified executives that is the Board of Directors. The conflict arises from the separation of ownership and control as the objectives of shareholders and directors are not aligned.

Another definition is given by the Organization for Economic Cooperation and Development (OECD, 2004) which mentions that corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders (OECD, p. 11). Each company has forces that apply pressure from within the entity and also from outside. The internal points of focus are given by the Board of Directors that through its nature and structure has the power and the means to establish the course of the company in terms of risk, operations, internal control, disclosure, and transparency.

Fulop&Cordos (2014) consider that "an efficient corporate governance system is based on a combination between the internal and external environment, with the scope of maximizing corporate performance, minimizing risk and the protection of investors and stakeholders interest". Stakeholders can be described as a person, a group or an organization that has interest in an entity, and both parties can affect or be affected by the others' actions, activities, policies, objectives. The internal stakeholders are seen as the Board of Directors, company secretary, sub-board management, employees and also employees' representatives like the trade unions. The Board of Directors has a certain status in the company as they are representing the shareholders, they can control the path that the entity takes, what risk can be taken,

decide on corporate governance, on short and long term strategy. The company rewards their efforts through basic pay, different bonuses, share options, with power and reputation. Management is responsible with implementing the vision of the Board of Directors; more involved in the day to day life of the company, having a better insight on the financial and operational performance of the company. The employees of every company are interested in a safe, stable and respectful environment, in a place that can bring satisfaction and where they can grow professionally. The employees are the first affected when a company chooses to cut costs and goes through a series of layoffs; the local community is also affected that is why trade unions found their use in the negotiation between employer and employee. The external shareholders are influenced by an organization but they are not part of it. Included in this category are the auditors, regulators, the government, third parties (suppliers, vendors), and investors.

Obtaining good corporate governance seen in business ethics, transparency, fairness, disclosure and social responsibility requires also knowing the regulatory framework that defines codes of best practice, law compliance and legal statute.

For Rampersad& Hussain (2014) "authentic corporate governance entails the systematic process of continuous, gradual, and routine corporate improvement, steering, and learning that lead to sustainable high corporate performance and ethical corporate excellence." Tone at the top is given by the directors and the way they act and take decisions affect the current operations of the company. A proper level of ethical behaviour cascades down to management and employees and has positive effect on the development of the company.

In the opinion of Kaen (2003) "corporate governance is about how the suppliers of capital make sure that they earn a return on the funds placed under the control of managers and make sure that the managers and other stakeholders don't take the money and run."

For obtaining a proper degree of morality throughout the company a certain attitude has to be considered:

- To treat all stakeholders with the same respect and readiness;
- Transparency of the decision making process;
- Fair reports on the financial status of the company and the disclosure of relevant information to all stakeholders;
- Independence of the directors as opposed to the shareholders, or independence of the non-executive directors, or of the auditors of the company; this provides reassurance that the operational and financial performance of the company is fairly presented and decision process is not tainted;
- Having in place a system of risk management and control that can address accountability of all parties involved.

The main corporate governance models are considered the Anglo-Saxon which emphasizes the interests of shareholders, the Continental and the Japanese models where stakeholder claims are usually taken into account in top management decisions. These models as well as the codes of conduct have evolved and are still developing, each of them more appropriate in one way or another for a certain country; which one is the best it is still to be decided.

3. BENEFITS OF CORPORATE GOVERNANCE AND TO WHOM DO WE ENTRUST ITS CARE?

Through its mechanisms corporate governance strives to develop a control structure where accountability increases and fraud is avoided. Related to the conflict of interest between principal (shareholders) and agent (directors) Larcker and Tayan (2013) consider that after analysing the current governance systems the self-interest is high due to the fact that the corporate governance check list is extensive. The decision of directors from large corporations to undertake risky activities in order to reach their imposed performance indicators, for cashing high bonuses, is seen as one of the causes of the financial crisis of 2007 -2008 in the financial-banking system in USA that also spread globally (Stiglitz, 2010 in Dinu&Ciora, 2012).

An important role in the corporate governance process is held by the auditors that have the responsibility to express an opinion on the financial statements of the company. The financial statements have to present fairly, in all material respects, the financial position of the company and the audit acts as an independent reviewer.

Related to audit issues Katzenbach, Steffen and Kronley (2012) analyse the scandal related to the audit firm Arthur Andersen (one of the Big Five) sustaining that the firm didn't collapse only due to the relation with bankrupt companies as Enron, WorldCom, as cracks started to appear in company's integrity with the 1950's when management changed focus from quality and honesty, in their fight for market share and higher incomes than the competition.

The objectives of good corporate governance are in the opinion of Fulop&Cordos (2014) the following:

- The consolidation of the management and of the supervisory responsibility;
- The complexity of the company's operations to be matched and to receive support from a management with a balance between skills, professional background and experience;
- To develop a code of business that sustains integrity;

- Financial reporting to be fair and to present the actual situation of the performance of the company;
- Risk management and internal control;
- Disclosure of relevant and material issues;
- Identifying the needs and expectations of shareholders.

Klapper and Love (2002) used data from Credit Lyonnais Securities Asia (CLSA) that calculated in 2001 an index of corporate governance for 495 companies in 25 emerging countries and 18 fields concluding that entities with higher governance index noted a better operating performance and higher stock returns.

The authors made their own analysis in order to draw a conclusion on the corporate governance processes at company level, on the relation with the legal environment at country level, and correlations between governance and performance. Their findings can be summarized as described below:

- companies in countries with overall weak legal system, occupy, on average, places on the bottom of the ranking;
- companies that are also traded on USA market have a higher degree of governance provisions, especially in countries with weak legal system;
- good corporate governance is linked with a better market value and higher operational performance.

Finally the authors sustain that improving corporate governance can be achieved but that this is a long-lasting process and in order to be successful it is required to have the support of the political class.

An interesting article was published by Morck and Steier (2005) where governance is principally the study of the mechanisms of capitalism and is defined as "decisions about how capital is allocated, both across and within firms." The purpose of their paper is to understand how capitalism came to mean different things in different parts of the world. In America, capitalism represents a system where large corporations fight with each other for customers, monopoly is against the law, and the true owners of the corporations are millions of middle class shareholders, disorganized and mostly powerless. In the rest of the world capitalism represents a system where few very wealthy families control almost all of a country's large corporations.

For proving their point authors use the study of La Porta et al. (1999) and their findings of who controls the large and medium sized companies across countries can be seen in Table 1. For example in Mexic large and middle sized corporation are controlled 100% by wealthy families. The countries with no controlling shareholders are United Kingdom (100%), USA (80%) and Australia (65%).

4. CONCLUSION

The separation of ownership and control has long been the key focus in the history of corporate governance due to the conflict of interests between the shareholders and the directors. The goals of the two parties differ as the shareholders fight to maximize the value of the company when the directors strive for status, high salary and bonuses, in short, the agent-theory starting point. Over time corporate governance was also affected and suffered changes under the influence of legal systems, culture, economic events, religion, politics and social struggles. However a company could not exist without the funds brought by the shareholders; that is why corporate governance is needed – to provide the tools for the company's growth, a company where all stakeholders are winners and not losers. Serious discussions followed after several high profile financial scandals that had in the midst directors that followed their personal interest; the subject of the debate was the power given to the directors and how the stakeholders, and not only shareholders, could have the certainty that directors won't take advantage of the position given to them. That is why regulators made changes in the legal framework in order to include reasonable assurance for the stakeholders. Governments and stock exchanges have proposed several codes of conduct and recommendations in order for good corporate governance to prevail. The provisions of these codes are not mandatory but not complying with them attracts the dissatisfaction of the general public that puts at stake the reputation of the company. Corporate governance function is to supervise the parties within a company that control the funds brought by investors and to be a pillar for corporate performance and accountability.

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Table No. 1

Who controls the World's Great Corporations

Country	No Controlling Shareholder	Governments	Widely Held Non-financial Firms	Wealthy Families	Widely Held Financial Institutions	Other
Argentina	**0%**	**15%**	**15%**	**65%**	**5%**	**0%**
Australia	**65%**	**5%**	**25%**	**5%**	**0%**	**0%**
Austria	**5%**	**70%**	**0%**	**15%**	**0%**	**10%**
Belgium	**5%**	**5%**	**0%**	**50%**	**30%**	**10%**
Canada	**60%**	**0%**	**15%**	**25%**	**0%**	**0%**
Denmark	**40%**	**15%**	**0%**	**35%**	**0%**	**10%**
Finland	**35%**	**35%**	**5%**	**10%**	**5%**	**10%**
France	**60%**	**15%**	**0%**	**20%**	**5%**	**0%**
Germany	**0%**	**25%**	**0%**	**10%**	**65%**	**0%**
Greece	**10%**	**30%**	**0%**	**50%**	**10%**	**0%**
Hong Kong	**10%**	**5%**	**0%**	**70%**	**5%**	**10%**
Ireland	**65%**	**0%**	**10%**	**10%**	**0%**	**15%**
Israel	**5%**	**40%**	**5%**	**50%**	**0%**	**0%**
Italy	**20%**	**40%**	**10%**	**15%**	**5%**	**10%**
Japan	**0%**	**5%**	**90%**	**5%**	**0%**	**0%**
Mexico	**0%**	**0%**	**0%**	**100%**	**0%**	**0%**
Netherland	**30%**	**5%**	**10%**	**20%**	**0%**	**35%**
New Zealand	**30%**	**25%**	**20%**	**25%**	**0%**	**0%**
Norway	**25%**	**35%**	**0%**	**25%**	**5%**	**10%**
Portugal	**10%**	**25%**	**0%**	**45%**	**15%**	**5%**
Singapore	**15%**	**45%**	**5%**	**30%**	**5%**	**0%**
South Korea	**55%**	**15%**	**5%**	**20%**	**0%**	**5%**
Spain	**35%**	**30%**	**10%**	**15%**	**10%**	**0%**
Sweden	**25%**	**10%**	**0%**	**45%**	**15%**	**5%**
Switzerland	**60%**	**0%**	**0%**	**30%**	**5%**	**5%**
United Kingdom	**100%**	**0%**	**0%**	**0%**	**0%**	**0%**
Unites States	**80%**	**0%**	**0%**	**20%**	**0%**	**0%**

Source:Morck&Steier (2005)