Journal of Business and Economics December 2014
Vol. 13 No. 2, p 180 - 188
ISSN: 1412-0070

21st CENTURY CORPORATE GOVERNANCE: BALANCING SHAREHOLDERS' AND STAKEHOLDERS' INTERESTS

Stanley S. Nangoy
snangoy@unklab.ac.id
Fakultas Ekonomi Universitas Klabat

Corporate governance is about the way in which boards oversee the running of a company by its managers, and how board members are in turn accountable to shareholders and the company. This has implications for company behavior towards employees, shareholders, customers and creditors. Good corporate governance plays a vital role in underpinning the integrity and efficiency of financial markets. Poor corporate governance weakens a company's potential and at worst can pave the way for financial difficulties and even fraud. Corporate governance is used by many companies to ensure that the relationship between management and their stakeholders is kept at a professional level. Just as the name governance suggests authority, the companies use this method to ensure that the company is not involved in any conflict with its stakeholders and in the case where it happens, there is a mechanism of how to solve them. It helps in ensuring discipline within the organization. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its stakeholders and should facilitate effective monitoring. If companies are well governed, they will usually outperform other companies and will be able to attract investors whose support can help to finance further growth.

Keywords: good governance, board function, corporate governance

INTRODUCTION

Corporate governance is the system by which companies are directed and controlled (Cadbury, 2012). It involves a set of relationships between a company's management, its board, its shareholders and other stakeholders; it deals with prevention or mitigation of the conflict of interests of stakeholders. Ways of mitigating or preventing these conflicts of interests include the processes, customs, policies, laws, and institutions which have impacts on the way a company is controlled. An important theme of corporate governance is the nature and extent of accountability of people in the business, and mechanisms that try to decrease the principal–agent problem.

Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. According to Davis in contemporary business corporations, the main external stakeholder groups are shareholders, debt holders, trade creditors, suppliers, customers and communities affected by the corporation's activities. Internal stakeholders are the board of directors, executives, and other employees. It guarantees that an enterprise is directed and controlled in a responsible, professional, and transparent manner with the purpose of safeguarding its long-term success. It is intended to increase the confidence of shareholders and capital-market investors (2006).

FEATURES OF CORPORATE GOVERNANCE

Companies use corporate governance to set a minimum standard of acceptable behavior for management and employees in the business. These features can include clear strategy, effective risk management, discipline, fairness, transparency, social responsibility and self-evaluation (Colley, Doyle, Green, & Stettinius, 2004; Vitez, 2006; Cadbury, 2012).

Clear Strategy. Good corporate governance starts with a clear strategy for the organization. For example, a furniture company's management team might research the market to identify a profitable niche, create a product line to meet the needs of that target market and then advertise its wares with a marketing campaign that reaches those consumers directly. At each stage, knowing the overall strategy helps the company's workforce stay focused on the organizational mission: meeting the needs of the consumers in that target market.

Effective Risk Management. Even if your company implements smart policies, competitors might steal your customers, unexpected disasters might cripple your operations and economy fluctuation might erode the buying capabilities of your target market. You can't avoid risk, so it's vital to implement effective strategic risk management. For example, a company's management might decide to diversify operations so the business can count on revenue from several different markets, rather than depend on just one.

Discipline. Corporate policies are only as effective as their implementation. A company's management can spend years developing a strategy to push into new markets, but if it can't mobilize its workforce to implement the strategy, the initiative will fail. Good corporate governance requires having the discipline and commitment to implement policies, resolutions and strategies.

Fairness. Fairness must always be a high priority for management. For example, managers must push their employees to be their best, but they should also recognize that a heavy workload can have negative long-term effects, such as low morale and high turnover. Companies also must be fair to their customers, both for ethical and public-relations reasons. Treating customers unfairly, whatever the short-term benefits, always hurts a company's long-term prospects.

Transparency. Managers sometimes keep their own counsel, limiting the information that filters down to employees. But corporate transparency helps unify an organization: When employees understand management's strategies and are allowed to monitor the company's financial performance, they understand their roles within the company. Transparency is also important to the public, who tend not to trust secretive corporations.

Social Responsibility. Social responsibility at the corporate level is increasingly a topic of concern. Consumers expect companies to be good community members, for example, by initiating recycling efforts and reducing waste and pollution. Good corporate governance identifies ways to improve company practices and also promotes social good by reinvesting in the local community.

Self-Evaluation. Mistakes will be made, no matter how well you manage your company. The key is to perform regular self-evaluations to identify and mitigate brewing problems. Employee and customer surveys, for example, can supply vital feedback about the effectiveness of your current policies. Hiring outside consultants to analyze your operations also can help identify ways to improve your company's efficiency and performance.

PRINCIPLES OF CORPORATE GOVERNANCE

According to Cadbury (2012) and Vitez (2006), the following principles of corporate governance are keenly studied:

Rights and equitable treatment of shareholders: Organizations should respect the rights of shareholders and help shareholders to exercise those rights. They can help shareholders exercise their rights by openly and effectively communicating information and by encouraging shareholders to participate in general meetings.

Interests of other stakeholders: Organizations should recognize that they have legal, contractual, social, and market driven obligations to non-shareholder stakeholders, including employees, investors, creditors, suppliers, local communities, customers, and policy makers.

Role and responsibilities of the board: The board needs sufficient relevant skills and understanding to review and challenge management performance.

Disclosure and transparency: Organizations should clarify and make information transparent to their stakeholders.

Integrity and ethical behavior: Integrity should be a fundamental requirement in choosing corporate officers and board members. Organizations should develop a code of conduct for their directors and executives that promotes ethical and responsible decision making.

Roles and responsibilities of board and management to provide stakeholders with a level of accountability. They should also implement procedures to independently verify and safeguard the integrity of the company's financial reporting. Disclosure of material matters concerning the organization should be timely and balanced to ensure that all investors have access to clear, factual information.

MODELS OF CORPORATE GOVERNANCE

Mohenson (2013) and O'Connel (2006) made a comprehensive studied about the three models of corporate governance and came up with the following discussions:

1. **Anglo-US Model**

The Anglo-US model is based on a system of individual or institutional shareholders that are outsiders of the corporation. The other key players that make up the three sides of the corporate governance triangle in the Anglo-US model are management and the board of directors. This model is designed to separate the control and ownership of any corporation. Therefore the board of most companies contains both insiders (executive directors) and outsiders (non-executive or independent directors). Traditionally, though, one person holds the position of CEO and chairman of the board of directors. This concentration of power has led many companies to include more outside directors now. The Anglo-US system relies on effective communication between shareholders, management and the board with important decisions being put to the vote of the shareholders (O'Connell, 2006). The Anglo-US model also permits shareholders to submit proposals to be included on the agenda of the annual general meeting (AGM). The proposals - known as shareholder proposals - must relate to a corporation's business activity. Shareholders owning at least ten percent of a corporation's total share capital may also convene an extraordinary general meeting (EGM) of shareholders.

In the US, the SEC has issued a wide range of regulations concerning the format, substance, timing and publication of shareholder proposals. The SEC also regulates communication among shareholders.

2. Japanese Model

The Japanese model involves a high level of ownership by banks and other affiliated companies and "keiretsu," industrial groups linked by trading relationships and cross-shareholding. The key players in the Japanese system are the bank, the keiretsu (both major inside shareholders), management and the government. Outside shareholders have little or no voice and there are few truly independent or outside directors. The board of directors is usually made up entirely of insiders, often the heads of the different divisions of the company. However, remaining on the board of directors is conditional on the company's continuing profits, therefore the bank or keiretsu may remove directors and appoint its own candidates if a company's profits continue to fall. Government is also traditionally influential in the management of corporations through policy and regulations (O'Connell, 2006).

In Japan, the routine corporate actions requiring shareholder approval are: payment of dividends and allocation of reserves; election of directors; and appointment of auditors. Other common corporate actions which also require shareholder approval include capital authorizations; amendments to the articles of association and/or charter (for example, a change in the size and/or composition of the board of directors, or a change in approved business activities); payment of retirement bonuses to directors and auditors; and increase of the aggregate compensation ceilings for directors and auditors. Non-routine corporate actions which also require shareholder approval include mergers, takeovers and restructurings.

Shareholder proposals are a relatively new phenomenon in Japan. Prior to 1981, Japanese law did not permit shareholders to put resolutions on the agenda for the annual meeting. A 1981 amendment to the Commercial Code states that a registered shareholder holding at least 10 percent of a company's shares may propose an issue to be included on the agenda for the AGM or EGM.

3. German Model

As in Japan, banks hold long-term stakes in corporations and their representatives serve on boards. However they serve on boards continuously, not just during times of financial difficulty as in Japan. In the German model, there is a two-tiered board system consisting of a management board and a supervisory board. The management board is made up of inside executives of the company and the supervisory board is made up of outsiders such as labor representatives and shareholder representatives. The two boards are completely separate, and the size of the supervisory board is set by law and cannot be changed by the shareholders. Also in the German model, there are voting right restrictions on the shareholders. They can only vote a certain share percentage regardless of their share ownership (O'Connell, 2006)

The routine corporate actions requiring shareholder approval under the German model are: allocation of net income (payment of dividends and allocation to reserves); ratification of the acts of the management board for the previous fiscal year; ratification of the acts of the supervisory board for the previous fiscal year; election of the supervisory board; and appointment of auditors.

Approval of the acts of the management board and supervisory board are basically a **"seal of approval"** or **"vote of confidence."** If shareholders wish to take legal action against individual members of either board or against either board as a whole, they refrain from ratifying the acts of the board for the previous year.

In contrast with the Anglo-US and the Japanese models, shareholders do not possess the authority to alter the size or composition of the supervisory board. These are determined by law. Other common corporate actions which also require shareholder approval include capital authorizations (which automatically recognize pre-emptive rights, unless revoked by shareholder approval); affiliation agreements with subsidiaries; amendments to the articles of association and/or charter (for example, a change of approved business activities); and increase of the aggregate compensation ceiling for the supervisory board. Non-routine corporate actions which also require shareholder approval include mergers, takeovers and restructurings. Shareholder proposals are common in Germany. Following announcement of the agenda for the meeting, shareholders may submit in writing two types of proposals. A shareholder counterproposal opposes the proposal made by the management board and/or supervisory board in an existing agenda item and presents an alternative. For example, a counterproposal would suggest a dividend higher or lower than that proposed by the management board, or an alternative nominee to the supervisory board. A shareholder proposal requests the addition of an issue not included on the original agenda. Examples of shareholder proposals include: alternate nominees to the supervisory board; authorization of a special investigation or audit; suggestions to abolish voting rights restrictions; and recommendations for changes to the capital structure. Provided that such proposals meet legal requirements, the corporation is required to publish these shareholder proposals in an amended agenda a nd forward them to shareholders prior to the meeting (Mohenson, 2013).

SIGNIFICANCE AND BENEFITS OF CORPORATE GOVERNANCE

Corporate governance protects the financial interests of individuals in a company, whether they are owners, managers, employees or outside stakeholders. Governance includes guidelines or policies that provide a framework individuals must follow when working in the company. Publicly held companies often have a board of directors as the overseers of corporate governance (Vitez, 2006).

According to Vitez, corporate governance can create a competitive advantage for companies in the business environment. Governance that provides specific responsibilities for each owner, manager and employee in the company ensures little or no confusion for competing activities or tasks related to business functions (2006).

The benefit of good corporate governance as as follows:

1. **Role clarity for the owners and management team.** Governance permits managers and owners to delineate their roles and separate the issues of ownership (shareholding) from the management of the business. This usually facilitates faster decision making as it allows managers and owners to choose which ‘hat’ to wear depending on the issue or matter at hand.
2. **Purposeful strategic direction**. Corporate Governance relies on the company defining and following a definitive strategic direction. This enables the owners and/or management to apply the right resources to the most beneficial opportunities. In turn this typically leads to the quicker achievement of company goals, while minimizing wasted resources on less important activities.
3. **Retention of staff**. Motivation increases when employees/staff are part of a business that has a well-defined and communicated vision and direction. This can improve staff retention which can become especially important when it

comes to attracting and retaining senior talent.

4. **Improved relationships with the bank**. Corporate Governance enables robust and regular financial and management reporting. The resulting systematic approach to producing data will foster confidence from the funders/banks as well as investors. Improved access to capital can be another flow-on benefit from sound Corporate Governance.

5. **Improvement in profitability**. Governance often leads to improved reporting on performance. This means managers and owners are better equipped to make higher quality decisions that can drive an increase in sales and margins and a reduction in costs.

PARTIES TO CORPORATE GOVERNANCE

Balance of power in the company raises the question of the relationship between the company in general meeting and the Board of Directors. All these bodies have distinct powers and controls of the company provided for in the Companies Act, and or the memorandum and articles of Association of the Company. The general meeting is principally responsible for election of the directors while directors are principally concerned with the management of the company. The question is which of the two bodies; Board and shareholders in general meeting has more powers in the control of the company and what should happen if one body misuses its powers to the detriment of the other (Aglietta & Reberioux, 2005).

The most influential parties involved in corporate governance include government agencies and authorities, stock exchanges, management (including the board of directors and its chair, the Chief Executive Officer or the equivalent, other executives and line management, shareholders and auditors). Other influential stakeholders may include lenders, suppliers, employees, creditors, customers and the community at large (Davies, 2006).

A board of directors is expected to play a key role to endorsing the organization's strategy, develop directional policy, appointing, supervising and remunerating senior executives, and ensuring accountability of the organization to its investors and authorities. All parties to corporate governance have an interest, whether direct or indirect, in the financial performance of the corporation. Directors, workers and management receive salaries, benefits and reputation, while investors expect to receive financial returns. For lenders, it is specified interest payments, while returns to equity investors arise from dividend distributions or capital gains on their stock. Customers are concerned with the certainty of the provision of goods and services of an appropriate quality; suppliers are concerned with compensation for their goods or services, and possible continued trading relationships. (Aglietta & Reberioux, 2005).

A key factor in a party's decision to participate in or engage with a corporation is their confidence that the corporation will deliver the party's expected outcomes. When categories of parties (stakeholders) do not have sufficient confidence that a corporation is being controlled and directed in a manner consistent with their desired outcomes, they are less likely to engage with the corporation. When this becomes an endemic system feature, the loss of confidence and participation in markets may affect many other stakeholders, and increases the likelihood of political action. There is substantial interest in how external systems and institutions, including markets, influence corporate governance (Aglietta & Reberioux, 2005).

FUTURE OF CORPORATE GOVERNANCE

The 2008 financial crisis has brought a lot of questions about the future of corporate governance. The speculation on the future of corporate governance suggests both a conclusion and a question: It will be different, but will it be more effective?

First, corporate governance in the future need to reflect an increasing emphasis on customer satisfaction as a way of measuring the adaptability of the organization over time. By focusing too strongly on financial records and audit committee work the company lose sight of the fact that departments like operations and human resources are very important components in forecasting future success. The world of corporate governance will benefit from the establishment of a new type of corporate information and control architecture. While agreeing that customer and employee satisfaction and loyalty are indeed good predictors for the future success of a company, it is suggested that these measures have to be viewed with a long-term lens, one that accommodates the fact that in the short-run, managements may take actions to reduce costs and the size of the labor force to achieve long-term success—actions that could adversely affect non-financial indicators used as inputs for corporate governance (Heskett, 2001).

Second, there have been indication that corporate governance model will need to be reformed. Corporate governance reform needs to be made a part of any sweeping overhaul of the financial system, which moves beyond reinforcing the shareholder primacy model, but stakeholders as primary model (Mosenson, 2013). Edward Freeman (Corplaw Admin, 2013), the original proposer of the stakeholder theory, recognised it as an important element of Corporate Social Responsibility (CSR), a concept which recognises the responsibilities of corporations in the world today, whether they be economic, legal, ethical or even philanthropic. Stakeholder theory states that a company owes a responsibility to a wider group of stakeholders, other than just shareholders. A stakeholder is defined as any person/group which can affect/be affected by the actions of a business. It includes employees, customers, suppliers, creditors and even the wider community and competitors.

Nowadays, some of the world’s largest corporations claim to have CSR at the centre of their corporate strategy. Whilst there are many genuine cases of companies with a “conscience”, many others exploit CSR as a good means of PR to improve their image and reputation but ultimately fail to put their words into action. Recent controversies surrounding the tax affairs of well-known companies such as Starbucks, Google and Amazon in the UK have brought stakeholder theory into the spotlight. Whilst the measures adopted by the companies are legal, they are widely seen as unethical as they are utilising loopholes in the British tax system to pay less corporation tax in the UK (Spanier, 2014).

Every company or business needs to incorporate good, fair and just corporate governance in their day to day activities. In this way activities within and outside the organization are controlled and well directed, ensuring there are no mistakes done, or no stakeholders of the company lose out on what they are entitled to get from the business.

As we move forward in the 21st century, it is the time to rethink the governance design of the corporate institution and it is also the time to genuinely improve the way we govern the business corporates.

REFERENCES

Aglietta, M., & Reberioux, A. (2005). *Corporate governance Adrift:A critique of shareholder value.* Cheltenham, UK: Edard Elgar.

Cadbury, A. (2012). *Report of the committee on the financial aspects of corporate governance.* London: GEE.

Colley, J., Doyle, J., Green, L., & Stettinius, W. (2004). *What is corporate governance.* New York: McGraw- Hill.

Collins, D. (2007, April 24). *"Assessing, Sustaining, and Enhancing an Ethical work Culture." Midwestern Intergovernmental Audit Forum.* http://business.edgewood.edu/ dcollins.

Corplaw Admin. (2013, July 16). *Shareholder and stakeholder theories of corporate governance.* Retrieved from Corpolaw: http://www.corplaw.ie/blog/bid/317212/Shareholder-Stakeholder-Theories-Of-Corporate-Governance

Davies, K., & Adrian, L. (2006). *Best practice in corporate governance-building reputation and sustainable success.* Burlington: Gower Publishing Limited.

Dogson, M. (2010). *The management of technological innovation: An international and strategic approach.* Oxford: Oxford University Press.

European, C. (2010). *Report on Greek government deficit and debt statistics.* Brussels: Brussels Printing Press.

Filho, L., & Walter. (2010). *Professionals´ Perspectives of Corporate Social Responsibility.* London: Oxford University Press.

Idowu, S. O., & Louche, C. (2002). *Theory and Practice of Corporate Social Responsibility.* Sheffield: UK: Greenleaf Publishing.

Mosenson, S. H. (2013). New models of private sector financing of not-for-profit corporations. *Unpublished dissertation, Norhteastern University Boston*. Boston: Northeastern University Boston.

O'Connell, B. (2006, March 16). *Models of corporate governance.* http://www.ehow.com

Spanier, G. (2014, April 25). *Starbucks UK sales fall in the wake of tax avoidance row*. Retrieved from London evening standard: http://www.standard.co.uk/business/business-news/starbucks-uk-sales-fall-in-wake-of-taxavoidance-row

Stiglitz, J. (2003). *"Ethics,market and Government Failure, and Globalization."*.www.2.gsb.Columbsa.edu

Tada, T., & Nihon, U. (2011). Information Security and Corporate Social Responsibility. *Corporate Social Responsibility and Human Resource Management*, 3(1) 34-46.

Vitez, O. (2006, March 16). *Importance of corporate governance.h*ttp://www.ehow.com