THE CONCEPT OF CORPORATE GOVERNANCE

Fabisch Wamukota

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Corporate governance is the system of rules, practices, and processes by which a company is directed and controlled. Corporate governance essentially involves balancing the interests of a company's many stakeholders, which can include shareholders, senior management, customers, suppliers, lenders, the government, and the community. As such, corporate governance encompasses practically every sphere of management, from action plans and internal controls to performance measurement and corporate disclosure.

# Benefits of Corporate Governance.

* Good corporate governance creates transparent rules and controls, guides leadership, and aligns the interests of shareholders, directors, management, and employees.
* It helps build trust with investors, the community, and public officials.Corporate governance can give investors and stakeholders a clear idea of a company's direction and business integrity.
* It promotes long-term financial viability, opportunity, and returns.It can facilitate the raising of capital.Good corporate governance can translate to rising share prices.
* It can reduce the potential for financial loss, waste, risks, and corruption.It is a game plan for resilience and long-term success.

## Corporate Governance and the Board of Directors.

The board of directors is the primary direct stakeholder influencing corporate governance. Directors are elected by shareholders or appointed by other board members and charged with representing the interests of the company's shareholders.

The board is tasked with making important decisions, such as corporate officer appointments, executive compensation, and dividend policy. In some instances, board obligations stretch beyond financial optimization, as when shareholder resolutions call for certain social or environmental concerns to be prioritized.

Boards are often made up of a mix of insiders and independent members. Insiders are generally major shareholders, founders, and executives. Independent directors do not share the ties that insiders have. They are typically chosen for their experience managing or directing other large companies. Independents are considered helpful for governance because they dilute the concentration of power and help align shareholder interests with those of the insiders.

The board of directors must ensure that the company's corporate governance policies incorporate corporate strategy, risk management, accountability, transparency, and ethical business practices.

### The Principles of Corporate Governance.

While there can be as many principles as a company believes make sense, some of the most common ones are:

* **Fairness**: The board of directors must treat shareholders, employees, vendors, and communities fairly and with equal consideration.
* **Transparency**: The board should provide timely, accurate, and clear information about such things as financial performance, conflicts of interest, and risks to shareholders and other stakeholders.
* **Risk Management**: The board and management must determine risks of all kinds and how best to control them. They must act on those recommendations to manage risks and inform all relevant parties about the existence and status of risks.
* **Responsibility**: The board is responsible for the oversight of corporate matters and management activities. It must be aware of and support the successful, ongoing performance of the company. Part of its responsibility is to recruit and hire a chief executive officer (CEO). It must act in the best interests of a company and its investors.
* **Accountability**: The board must explain the purpose of a company's activities and the results of its conduct. It and company leadership are accountable for the assessment of a company's capacity, potential, and performance. It must communicate issues of importance to shareholders.

#### Corporate Governance Models.

There are many types of corporate governance that a company might follow. Some use a traditional hierarchical leadership structure, and others are more flexible. Different corporate governance models may be found throughout the world. Here are a few of them.

**The Anglo-American Model**

This model can take various forms, such as the Shareholder, Stewardship, and Political Models. The Shareholder Model is the principal model at present.The Shareholder Model is designed so that the board of directors and shareholders are in control. Stakeholders such as vendors and employees, though acknowledged, lack control.Management is tasked with running the company in a way that maximizes shareholder interest. Importantly, proper incentives should be made available to align management behavior with the goals of shareholders/owners.The model accounts for the fact that shareholders provide the company with funds and may withdraw that support if dissatisfied. This is supposed to keep management working effectively.The board will usually consist of both insiders and independent members. Although traditionally, the board chairperson and the CEO can be the same, this model seeks to have two different people hold those roles.The success of this corporate governance model depends on ongoing communications among the board, company management, and the shareholders. Important issues are brought to shareholders' attention. Important decisions that need to be made are put to shareholders for a vote.U.S. regulatory authorities tend to support shareholders over boards and executive management.

**The Continental Model**

Two groups represent the controlling authority under the Continental Model. They are the supervisory board and the management board.In this two-tiered system, the management board is composed of company insiders, such as its executives. The supervisory board is made up of outsiders, such as shareholders and union representatives. Banks with stakes in a company also could have representatives on the supervisory board.The two boards remain entirely separate. The size of the supervisory board is determined by a country's laws and can't be changed by shareholders.National interests have a strong influence on corporations with this model of corporate governance. Companies can be expected to align with government objectives.This model also greatly values the engagement of stakeholders, as they can support and strengthen a company's continued operations.

**The Japanese Model**

The key players in the Japanese Model of corporate governance are banks, affiliated entities, major shareholders called Keiretsu (who may be invested in common companies or have trading relationships), management, and the government. Smaller, independent, individual shareholders have no role or voice. Together, these key players establish and control corporate governance.The board of directors is usually made up of insiders, including company executives. Keiretsu may remove directors from the board if profits wane.The government affects the activities of corporate management via its regulations and policies.In this model, corporate transparency is less likely because of the concentration of power and the focus on the interests of those with that power.

## How to Assess Corporate Governance

As an investor, you want to select companies that practice good corporate governance in the hope that you can thereby avoid losses and other negative consequences such as bankruptcy.

You can research certain areas of a company to determine whether or not it's practicing good corporate governance. These areas include:

* Disclosure practices
* Executive compensation structure (whether it's tied only to performance or also to other metrics)
* Risk management (the checks and balances on decision-making)
* Policies and procedures for reconciling conflicts of interest (how the company approaches business decisions that might conflict with its mission statement)
* The members of the board of directors (their stake in profits or conflicting interests)
* Contractual and social obligations (how a company approaches issues such as climate change)
* Relationships with vendors
* Complaints received from shareholders and how they were addressed
* Audits (the frequency of internal and external audits and how any issues that those audits raised have been handled)

**Types of bad governance practices include**:

* Companies that do not cooperate sufficiently with auditors or do not select auditors with the appropriate scale, resulting in the publication of spurious or noncompliant financial documents
* Executive compensation packages that fail to create an optimal incentive for corporate officers
* Poorly structured boards that make it too difficult for shareholders to oust ineffective incumbents.

##### What Are the 4 Ps of Corporate Governance?.

The four P's of corporate governance are people, process, performance, and purpose.

## The Bottom Line

Corporate governance consists of the guiding principles that a company puts in place to direct all of its operations, from compensation, risk management, and employee treatment to reporting unfair practices, dealing with the impact on the climate, and more.

Corporate governance that calls for upstanding, transparent behavior can lead a company to make ethical decisions that will benefit all of its stakeholders, including investors. Bad corporate governance can lead to the breakdown of a company, often resulting in scandal and bankruptcy.

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