Review

Corporate governance: A panacea to board accountability and value creation?

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Abstract

After some of the well-publicised cases of corruption and malfeasance in several large public corporations, especially at the executive and board levels, business investors and analysts are searching for management tools to measure the vulnerability of firms to dishonesty, fraud, and corruption, often fronted by top executives. To ensure that organisations operate in a transparent environment and serve the interest of all stakeholders, good governance is often touted as a panacea to the problems associated with unethical corporate practices. The issue at stake here relates to financial disclosure, shareholder rights, related-party transactions, and executive compensation. The article includes the evolution of the corporate governance debate, and uses contemporary business examples of corporate malfeasance to discuss how these examples are used to argue the case for improved governance and the need for protection for investors and other stakeholders from decisions made by CEOs and corporate BoD. The article concludes that corporate governance cannot be a panacea to effective corporate accountability and value creation, as corporate malfeasance still persist in spite of recent changes to governance codes. However, corporate malfeasance, malpractices and unethical activities are minimised with good governance.

Keywords: Stakeholders, Corporate Governance, Corporate Citizenship, Value Creation, Board of Directors, Agency theory, Malfeasance.

Review of Subject

Much of the pages in Huse (2007) have been devoted to looking at how corporate BoD relate to actors, internal and external, in their responsibility not just to shareholders but to a larger community of stakeholders who influence decision making within the organisation. It is the intention of this paper to explore the concept of corporate governance and how Board of Directors (BoD) can contribute to value creation and meet the level of accountability that companies owe to stakeholders. The paper also provides a different conceptual position about board performance and board tasks and discusses whether corporate governance is the solution to organisational effectiveness and corporate citizenship.

What is corporate governance?

Literature on the subject provides a number of definitions for corporate governance. Huse (2007) defines corporate governance as “the interaction between various internal and external actors and the board members in directing a firm for value creation” (p. 15). In this definition, Huse, (2007) examines how BoD contribute to value creation and highlights the ethical dimensions of corporate
governance. In doing so, it recognises that there is interplay of various actors who influence decision making. It also asserts that the various actors may or may not have a common objective. Consequently, board effectiveness is concerned with accountability and who and what really matters in the process of value creation.

An alternative definition of corporate governance is provided by Corporate Governance - Definition, Scope and Benefits, (n. d.) as “the interaction between various participants (shareholders, BoD and company’s management) in shaping corporation’s performance and the way it is proceeding towards” (p. 1). The article posits that the relationship between the owners and the managers in an organization must be healthy and there should be no conflict between the two parties. It stresses that the owners must see that individual’s actual performance must be in accordance with corporate standards. According to the article, governance is about the BoD making decisions that ensures that providers of finance guarantee themselves of getting a fair return on their investment – the essence of value creation. However, in doing so, they undertake actions that guarantee transparency and ensure strong and balanced economic development. At the same time, BoD encourage trustworthy, moral, as well as ethical environment which ensures that organisational activities do not compromise other stakeholder interests.

The OECD define corporate governance as involving a “set of relationships between a company’s management, its board, its shareholders and other stakeholders” (Definition of Corporate Governance, n. d.). The OECD go on to stress that corporate governance should provide the structure through which the objectives of companies are set, and the means by which attaining those objectives and monitoring performance are determined. The basis of this definition, while not ignoring the important relationships between the company and its external stakeholders, focuses on the uneasy relationship between ‘disconnected owners’ and often ‘self-serving managers’ and the effect of agency theory in this broad relationship. Implicit in this definition is an “adversarial relationship between management and investors, and an attitude of mutual suspicion” (p. 1). The result of this suspicious relationship is the need for systems of independent monitoring and controls that ensure that there is alignment between board performance, board tasks and shareholder expectations.

However, Tricker (2012) views corporate governance from different perspectives and provides definitions reflecting each alternative viewpoint. According to Tricker (2012), the practitioners that focus on governance structures and practices define corporate governance as “the system by which companies are directed and controlled” (p.29). In this definition, the author explains that BoD are responsible for the governance of their companies, and the responsibility of owners is to appoint directors and auditors to protect their interest and satisfy themselves that an appropriate governance structure is in place. Another view taken from a relationship perspective defines the concept as “the relationship among the shareholders, directors and management of a company, as defined by the corporate charter, by-laws, formal policy, and rule of law” (p. 30). In this definition, the emphasis is laid on the interactions between the owners and agents appointed to run the affairs of the organisation. Here again, the aspect of value creation, organisational behaviour and conformance to governance codes is embodied within the broad complexities of the relationship. The economic viewpoint perceives corporate governance in the context of “the way suppliers of finance assure themselves of getting a return on their investment” (p. 30). The main concern here is the ownership concentration in the governance systems and the legal protection available to investors. Finally, the societal perspective defines corporate governance as concerning itself with “holding the balance between the economic and social goals and between individual and communal goals” (p. 31).

All the above definitions of corporate governance take cognisance of the existence of various actors whose needs must be taken into consideration in an effort to create value. Although the primary goal of all companies is profitability, there is the general expectation that sustainable value creation can only be guaranteed in an environment where there is accountability and the BoD act in ways that are deemed to be ethical and which do not consider profitability as a case of ‘be all and end all’. There is also the acknowledgement that under different circumstances different actors may be more influential than others and will act quite decisively to protect their respective interests.

**Evolution of the corporate governance debate**

The emergence of capitalism and how capital is accumulated around the world gave rise to the debate about corporate governance. In this regard, Morck and Steier (2005) argue that the ways that different economies and different countries accumulate and allocate capital is different and relates quite closely to how each country handles the issue of corporate governance. Taking the longest possible view, the issue of corporate governance has been around for as long as there has been a separation between the ownership and the control of commercial concerns. However, over the years, the corporate governance movement has taken many forms during its evolution. Although tracing the entire history of the development of corporate governance is not the intention of this paper, a brief outline of key moments in the debate is presented.

The history of corporate governance can be traced back to the 1912-1913 when the Pujo committee investigated the ‘money trust’ (Pujo Committee: Money...
Trust" Wall Street Banking Cartel Investigation 1912-1913, 2011) and identified a sophisticated network of financial conglomerates that exerted significant control and influence over the U.S. economy and monetary system. The committee concluded that a group of financial leaders had abused the public trust to consolidate control over many industries. The report of the committee created a climate of public opinion that “led to the passage of the Federal Reserve Act of 1913 and the Clayton Antitrust Act of 1914” (p. 1).

In 1933, the establishment of the Securities and Exchange Commission (SEC) and the implementation of the securities act were designed to protect investors and maintain the integrity of the securities markets. The main goal of the SEC activity was primarily to promote disclosure of important information, enforcing the securities laws, and protecting investors who interact with these various organizations and individuals. According to SEC Law ans Legal Definition, (n. d.), the SEC is a federal agency responsible for administering federal securities laws that protect investors. The SEC also ensures that securities markets are fair and honest and, if necessary, enforces securities laws through the appropriate sanctions. Basically, the SEC oversees the activities of all participants in the securities markets - including publicly held corporations, public utilities, investment companies and advisers, and securities brokers and dealers—to ensure that investors are adequately informed and their interests are protected.

The activities of the SEC led to the passing of a number of legislation which strengthened the disclosure laws and further protected the investors from unscrupulous dealing by brokers and the securities market. An example of SEC actions in regards to this is the charging of Penn Central Railroads and its executives and a top accounting firm with massive fraud that it said cost investors in the bankrupt railroad and subsidiaries billions of dollars. This was followed by a number of high profile cases in which the SEC intervened including the now infamous Enron and Worldcom scandals in America and the Asil Nadal's Polly Peck, BCCI and the Maxwell Communications Corporation in the UK.

The outline of some of the key moments discussed above provide a brief highlight of the chronological evolution of the corporate governance debate and the process towards better transparency, accountability and the need for BoD to act in ways that are seen as ethical, ensuring that the interest of all stakeholders are protected. The advent of technology has increased the risks associated with fraud, making the need for effective monitoring of business activities, especially at board level, more pertinent. There are on-going issues with related party transactions, where abuses can easily be concealed using electronic systems of transferring funds. The increasing pressures on CEOs to improve profitability and raise business competitiveness in the modern business environment also increase the prevalence of unethical practices. Thus the call for effective governance systems is becoming louder, ensuring that organisations don’t settle for short term profit maximisation at all costs but that sustainable practices are enshrined in company policies to achieve long term goals. This is in line with the assertion by Robert Hingley, Director of Investment Affairs of the Association of British Investors that “good governance enhances a company’s sustainable performance and so helps underpin long-term economic growth” (Improving Corporate Governance and Shareholder Engagement, n. d. p. 1.).

Why Corporate Governance?

After some of the recent well-publicised cases of corruption and malfeasance in several large public corporations, especially at the executive and board levels, investors and analysts are searching for management tools to measure the vulnerability of firms to dishonesty, fraud, and corruption, (Sonnenfeld, 2004). While this effort to improve governance through uniform guidelines is understandable, at times BoD and companies are reaching out for any life preserver that comes along. Some firms are even capitalizing on this desperation by setting themselves up as corporate governance experts. The concept of good governance is often touted as a panacea to the problems associated with unethical corporate practices. However, others believe that the whole idea of corporate governance is often over emphasised which can be a real distraction from what the main issue is about. Sonnenfeld (2004) reveals that in a recent review of academic studies on governance, the Financial Times suggested that many of the supposedly preventive practices advocated are not truly related to better performance and concluded that perhaps it is time the corporate governance activists came under the sort of scrutiny to which they subject listed companies.

The issue at stake here relates to financial disclosure, shareholder rights, related-party transactions, and executive compensation. The expectation is that effective governance will eradicate, or at least, control the risks associated with these practices. Below is a brief discussion on each of them and how effective governance will address them.

Financial disclosure

The section C of UK governance code states that companies have an obligation to “present a fair, balanced and understandable assessment of the company’s position and prospects” (UK Corporate Governance Code, 2012). In regards to this it is the responsibility of the board to present a fair, balanced and understandable
assessment which extends to interim and other price-sensitive public reports and reports to regulators as well as to information required to be presented by statutory requirements. The code stipulates that BoD should establish arrangements that will enable them to ensure that the information presented is fair, balanced and understandable. Across the developed economies, similar codes are in place to protect the interest of investors and enhance the efficiency of security markets (Meier-Schatz, 2011). Having said that, it is the view of Meier-Schatz (2011) that the investor protection objective of governance codes is diminishing in its significance and rather it is the emphasis on information rather than protection of investors which is overwhelmingly welcomed in the academic community. In view of this, the expectation that corporate governance will eradicate or even control the accountability problems associated with financial disclosure is waning. Rather the debate in corporate governance literature is increasingly pointing to the efficiency of the security markets as explained in the findings of Ahmad-Zaluki and Hussin (2009) that concluded that “effective governance is associated with high quality information flowing from management to investors” (p. 34).

Related party transaction (RPT)

Related Party Transaction (RPT) is where a business transaction is undertaken by a manager or director on the behalf of the company or its subsidiaries (Kicha, n. d.). According to web definition, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions. Although RPT is a basic human instinct occurring in most business transactions, there is a possibility that some of such transactions might not have occurred on ‘arm’s length’ consideration (Kicha, n. d.). In the corporate world, some Agents may enter into some aspect of business transactions with their own interest at heart, contributing to substantial economic losses to the Principal, and eroding investors’ confidence regarding the usefulness and reliability of financial statements. Although RPT is prevalent in emerging economies, there are global concerns regarding the practice with many developed economies instituting various laws and regulations that stipulate the deeper scrutiny and the greater disclosures of such transactions. A case in point is the infamous Satyam scam case of 2009 which is often described as India’s biggest corporate fraud (Bhasin, 2013) which brought into sharp focus attention on corporate ethics and corporate governance. This example of corporate fraud committed by the founders of Satyam in 2009 is a testament to the fact “the science of conduct is swayed in large by human greed, ambition, and hunger for power, money, fame and glory” (p. 1.). It is such incidences of corporate scandals that effective governance is supposed to combat to bring sanity to corporate world and enhance the integrity of financial reports to investors. Unfortunately, recent cases involving Enron, Worldcom, Tyco and many others cast some doubts over how corporate governance codes are helping to achieve this.

Shareholder rights

It is only fair that people who invest in business are given opportunities to have a say in the running of the company. In modern business effective financial communications and investor relations play key roles in forging an understanding between a public company’s directors and its shareholders (Koeneman and Ludke, n. d.). CEOs and the board thus have an obligation to engage shareholders in a “regular, systematic contact at senior executive level for the purposes of an exchange of views and information on strategy, performance, board membership and quality of management” (Improving Corporate Governance and Shareholder Rights, n. d., p. 5). Such an engagement is likely to lead to shareholder satisfaction and job security for inside board members. It also provides a strategic direction for the company, and ensures the effective monitoring of management by the BoD and the accountability of management and directors to shareholders. The involvement of shareholders, especially during the annual general meeting (AGM) can also introduce ideas from the expertise of owners with knowledge and experience in other areas that may be relevant to the company. More importantly, enhancing opportunities for shareholder engagement can also have the potential for long term financial investment and increase the stability of financial flow within the company leading to long-term value creation and economic growth. In spite of the value in the BoD maintaining a good relationship with shareholders by upholding their rights and maintaining effective communication with both majority and minority shareholders, there needs to be a balance to avoid unwanted distractions from shareholder expectations. Investors often have diverse range of expectations ranging from value creation to ethical practices, the responsibility of the CEO and the board is to ensure that there is a sound and sustainable vision in place that provides opportunities for value creation in the long run.

Executive compensation

In recent years, the salaries and compensation packages give to top executives have come under increased scrutiny with many people questioning the morality of paying excessive compensation packages to some executives. A case in point involves McDonalds and its
CEO in 2009. According to the story, in 2009, James Skinner, CEO of McDonald’s, received total compensation of $17.6 million. This included salary of $1.4 million, an annual bonus of $3.3 million, a long-term cash award of $8.3 million, stock awards of $1.7 million, stock options of $2.2 million, and benefits and perquisites of $0.7 million. Skinner’s employment contract also included a change-in-control provision under which he would receive three times his base salary and bonus if McDonalds was sold to another company. The change-in-control provision was valued at $19.9 million in 2009. Executive compensation levels have been criticised in recent years, giving rise to shareholder activism. (Definition of executive compensation, n. d., p. 1.)

This was immediately followed by the package given to Sir Fred Goodwin, the ex-CEO of Royal Bank of Scotland (RBS). The bank had to be bailed out by the British tax payer to the tune of £20 billion during the credit crunch in 2008 when he was at the helm of affairs at the bank. Even so, a Daily Telegraph report at the time stated that Sir Fred Goodwin was paid of £4.2 million, including a £2.86 million bonus, only months before the bank hit crisis point and needed the British government to bail it out (Kirkup, 2008). He had an £8.37 million pension pot that will pay him £579,000 per year when he reaches the bank’s retirement age and also owned 2.53 million shares in RBS, though the value of that holding may be slashed as the bank takes state help.

In a similar move to curb the so-called ‘fat cats’ compensation scheme to top executives, a BBC report only last year announced that Swiss voters have overwhelmingly backed proposals to impose some of the world’s strictest controls on executive pay, final referendum results showed (BBC News Europe, 2013). It is claimed that “nearly 68% of the voters supported plans to give shareholders a veto on compensation and ban big pay-outs for new and departing managers (p. 1). The EU had approved measures to cap bankers’ bonuses only days before the Swiss vote.

All these incidences and subsequent intervention measures are indications that in spite of the strengthening of corporate governance rules across most of the developed economies, there is still a long way to go to ensure board accountability to investors and the wider stakeholders. Despite the attempts to regulate and control the activities of BoD and improve the governance of corporations, the internet is littered with numerous examples of corporate malfeasance around the world. A few of examples are listed below:

- Holbrook (2010) reports about pharmaceutical maker Roche as refusing to sell its HIV drug Fuzeon at $18,000 (what it was valued at by South Korean health officials) as opposed to $25,000. Even though the drug maker would still make a hefty profit, it refused to sell at the discounted price with the head of Roche’s Korean division claiming, “We are not in the business to save lives, but to make money.

- Saving lives is not our business.” (p.1)
- WellPoint didn’t fare so well in the spotlight after the U.S. health care debate raged this year. It was found that the insurance company was severely abusing rescission (the policy of finding ways to cancel insurance contracts). Whose contracts were they cancelling? Women who were diagnosed with breast cancer.
- Investment banking house Goldman Sachs created Abacus 2007-AC1, a fund of mortgages it sold to investors. What Goldman didn’t tell Abacus fund investors was that the mortgages they were betting would succeed, had been handpicked by a favourite Goldman investor to actually lose.
- The Royal Dutch Shell Company has a legacy of extracting oil from the Niger Delta of Nigeria since 1958. Between 1990 and 1995, Shell, in collusion with the military government, financed the use of deadly force against the Ogoni people, who strongly protested Shell’s presence in the region due to the stark devastation the company had on the environment. The Delta Natural Resource Damage Assessment and Restoration Project deemed the Niger Delta as, “as one of the world’s most severely petroleum-impacted ecosystems.” (Villeamy, 2014. P.1.)
- Nike, one of the world’s leading producers of footwear, sporting goods, and apparel has come under major scrutiny for outsourcing production to developing countries to exploit cheap labour and maximize profits since the mid 1990’s. Global Exchange has tracked and researched these abuses and in 2001 published, ‘Still Waiting for Nike to Do It’: Nike’s Labour practices in three years since CEO Phil Knight’s speech to the National Press Club. The book covers all abuses of Nike sweatshops from inadequate wages and working hours to safety hazards and the inability to organize. This business model has tarnished Nike’s reputation dramatically and since then Nike’s public relations representatives and CEO have made numerous statements as to how it will improve their workers’ circumstances.

The malfeasance case list goes on. The well-publicised cases of Enron, Worldcom, BCCI and Polypeck have been mentioned above. These and many other cases of bad corporate practices have affected big corporations and even national economies, wiping off billions of dollars off the financial markets and permanently damaging the image of big brands and in some cases precipitated the collapse of many big corporate institutions.

These high-profile cases have been the catalyst for improved governance and have demanded protection for investor and other stakeholder from decisions made by corporate BoD. Admittedly, the ensuing regulations have minimised the chances of corruption at board level and ensured that big companies who, hitherto, mistreated investors and other stakeholders with impunity have
begun to be more accountable to shareholders and society at large. Indeed, many aspire to raise the banner of corporate citizenship, taking their corporate social responsibility with the desired seriousness and honesty and much more conscious of their ethical behaviour.

In spite of this, Larker and Tayan (2011) assert that in the process of trying to find the solution to corporate malfeasance and unethical corporate behaviour, certain myths have developed that continue to be accepted, despite a lack of robust supporting evidence. A few of these are listed below:

**The structure of the board equals the quality of the board**

The most commonly accepted myth in corporate governance is that the structure of the board always tells you something about the quality of the board. Huse, (2007) posited that some big American firms have started appointing prominent environmentalists to their corporate BoD as a strategic decision to have access to sophisticated outside views on environmental issues and to present a more ethical face. To this end, governance experts often evaluate a board by placing considerable emphasis on its prominent observable attributes. However, according to Larcker, and Tayan, (2011), “these attributes have been rigorously studied by researchers and, for the most part, have been shown to have little bearing on governance quality. Instead, board quality is likely to be determined by attributes that are less well examined, including the qualification and engagement of individual directors, boardroom dynamics, and the processes by which the board fulfils its duties.” (p. 1).

**There is no performance-related pay in CEO compensation**

Performance-related pay is the notion that the amount of compensation awarded to an executive should be related to the value of the services rendered during a specified period. Some critics contend that there is no connection between these two and that pay for performance does not exist in the U.S. While there are examples of unreasonable compensation, it is not true that the typical CEO is not paid to perform. On average, CEOs hold a personal equity stake in the companies they manage with a median value of $4.6 million. (Larcker, and Tayan, 2011). This includes the fair value of stock directly held and equity grants, such as stock options and restricted stock. A one percent change in the company’s share price translates into a roughly $54,000 change in the underlying value of these holdings. If the CEO doubles the stock price, he or she stands to realize $5.2 million in appreciated value.

**Regulation Improves Corporate Governance**

In the last ten years, two major pieces of legislation have been enacted in the United States relating to governance. The first is the Sarbanes-Oxley Act of 2002. The second is the Dodd-Frank Act of 2010. “Despite the increased ‘federalization’ of corporate governance, there is little evidence that legislative mandates improve corporate outcomes” (Larcker, and Tayan, 2011). For example, ten years after the passage of Sarbanes-Oxley, experts are still debating whether the regulation is cost effective. Similarly, the Dodd-Frank Act imposes governance changes on companies that were previously at the mercy of the board and its shareholders. Two of its key provisions include proxy access and stay-on-pay. There is no evidence that these provisions improve corporate outcomes. As a matter of fact, “some research findings suggest that, Dodd-Frank is more likely to destroy than enhance shareholder value” (Larcker and Tayan, 2011).

**Best practices are the solution**

Finally, the most destructive myth in corporate governance is the notion that there are best practices in the corporate world that leads to better oversight and performance. This is simply not the case. Despite the best efforts of regulatory, commercial, and academic experts, no one has yet identified standards that are consistently associated with improved corporate outcomes. Larcker, and Tayan, (2011) asserted that it should not be surprising that uniform best practices do not exist in governance. They explain that, corporations are organisational systems. Their success is predicated on their external setting, the interactions of their constituents, and the processes by which the corporate strategy is planned and executed. It is hard to imagine that the complexity of such an undertaking can be reduced to a checklist that is no more difficult to follow than the recipe in a cookbook. Rather than focus on check-the-box solutions, governance can only be improved when corporate practitioners and their constituents give the matter the careful consideration it deserves. (p. 4 and 5).

**CONCLUSIONS**

There is no doubt that good governance benefits all actors in the corporate governance debate. Evidence noted in this article suggests that legislation on corporate behaviour has stemmed the tide of corporate malfeasance and made BoD more accountable to stakeholders. This re-assures investors and protects society in general. However, it is also worth noting that in today’s corporate world greed and self-indulgence means that unscrupulous executives will take advantage of legal
loopholes and even look for opportunities to engage in acts that may be deemed as unethical. Some of the mythical assumptions have also muddied the corporate governance water and reinforced certain behaviours and allowed dishonest executives to hide under the cover of good corporate governance that have made their activities gone undetected until sometimes when it is too late, often with detrimental consequences. As a result, Larcker, and Tayan, (2011) argues that decisions regarding the structure and processes of a governance system should be based on concrete evidence, not the educated guesses of self-styled experts. To this end, a comprehensive and rigorous body of research exists that examines many of these important questions. It is the belief of the author that the findings of research documents should be consulted and carefully considered when governance decisions are being made to tailor governance rules to specific situations and tighten the loopholes that are often exploited by unscrupulous executives.

It can therefore be concluded that with all its best interest and intentions corporate governance cannot be a panacea to effective corporate accountability and value creation. Malfeasance, malpractices and unethical activities can only be minimised with good governance but cannot be completely eradicated.

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