

## **CORPORATE GOVERNANCE AND ORGANISATIONAL PERFORMANCE**

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### **—Abstract —**

Several companies within the context of Zimbabwe folded especially during the turn of the new millennium, companies in the private and public sectors alike were affected mainly by corporate scandals. It is in this context that this paper sought to develop a corporate governance framework to enhance the performance of organisations. The discourse was guided by a fusion of the following theories: the agency theory, the ethical theory, the stakeholder theory, the corporate social responsibility theory and the steward theory. The theories were used as a lens through which review of related and relevant literature was employed. For this discussion literature review methodology was used to determine the source of material for review. Document analysis of peer-reviewed literature was used as the main source of information and data about corporate governance issues in private and public institutions. In the discussion, relevant corporate governance theories were outlined. From the exposed theories, a corporate governance framework was developed to enhance the performance of parastatals private and public institutions in Zimbabwe. In conclusion, the paper focused on a governance system that advances transparency, accountability business ethics and a governance framework that promotes business growth in terms of credibility and performance.

**Key Words:** Corporate governance, Performance, Organisation, Structure, Framework

**JEL Classification:**M14

## **1. INTRODUCTION**

The objective of this paper is to present a corporate governance framework that provides an insight of corporate governance practices that influence company performance through acceptable corporate governance practices. The absence of a structured governance system has resulted in a mismanagement of organisations riddled with corporate fraud, dishonesty and a host of numerous corporate scandals. Globalisation and information technology has made the governance of firms complex but at the same time relevant, because corporations have become powerful in that information can now be relayed faster than before across the world. Accountability has become more important. The paper further seeks to pursue the corporate governance framework ideal for growth in organisational performance in terms of return on investment, growing shareholder confidence and maximising shareholder profits. The recent developments in corporate governance reveal that the phenomenon now recognise the rights of not only the shareholders, but of others who are touched by the actions of corporations (Stiglitz, 2006). It is against this background that this paper reviews theories that are fundamental to corporate governance. The theories discussed here include; the agency theory, the stakeholder theory, stewardship theory, ethical theory incorporating corporate social responsibility theory and the political theory. Further the corporate governance internal and external control mechanisms are unpacked through detailing the composition of the various players, for example the board of directors, non-executive directors, audit committees among others. A proposed corporate governance framework is proffered which draws its matrix from the reviewed theories.

## **2. CORPORATE GOVERNANCE DEFINED**

World Bank (1995) defines corporate governance as a system by which organizations are controlled and directed. It further states that corporate governance is concerned with processes, systems, controls, accountabilities and decision making at the center and being of greater importance in an organization. The Organization for Economic Cooperation and Development (2000) asserts that the distribution of responsibilities and rights among different participants in the corporation such as managers, the board, shareholders and stakeholders are specified by the corporate governance structure. OECD (2000) also

gives a summary on corporate governance highlighting that it is about accountability, transparency, responsibility and power distribution within an organization. Fisher (2011) also points out that corporate governance is a set of customs, processes, laws, policies, affecting the way a company is heading for, controlled and administered. Taking a broader view of the issues at hand, Gillan and Starks (1998) view corporate governance as the system of laws, rules and factors that control operations at a company. The definitions can vary but the fundamentals of corporate governance point to two issues namely, those internal and external to the organisations or firms. The internal governance is made up of the management which acts as the shareholders' agents. On the other hand, external governance arises from the firm's need to raise capital. The complexity of the concept of corporate governance focuses on values such as transparency, accountability, fairness, and responsibility. The foundation of any structure of corporate governance is disclosure. The positive notions of disclosure and openness gives merit and impetus to corporate governance as a progressive governance system based on honesty. Shleifer and Vishny (1997) observe that suppliers of finance use corporate governance to ensure return on investment. The separation of roles between those who provide capital and those who manage it requires corporate governance structures that ensures every group's responsibilities are constantly checked for consistence and adherence to laid out standard operating procedures. Groups that fall in the matrix of corporate governance structures include board of directors, managers, shareholders, debtholders, employees, suppliers and customers. The community in which the firm operates provides the environment which has the political influence, laws, regulations and more generally the markets, which is very important for company operations. Laws and politics have great influence on corporate governance and the way the firm operates.

## **2.1 Theories of Corporate Governance**

The need to strengthen the concept and practice of corporate governance within the framework of certain theories cannot be overemphasized. These include among others: Agency Theory, Stewardship Theory, Stakeholders Theory, Corporate Social Responsibility Theory, Ethical Theory, and Political Theory outlined below.

## **2.2 Agency Theory**

Agency theory suggests that the company can be viewed as relationship of contracts between company executives or managers and shareholders, and it has its roots in economic theory (Jensen & Meckling, 1976). Principals who are the owners of the company hire the agents to do the work. Work is delegated by the owners who are the shareholders, to the directors or managers, who are the shareholders' agents (Clarke, 2004). Daily, Dalton and Canella (2003) give prominence to two issues and point out that the company is reduced to two major players, the management team and shareholders. Self-interest by management is one issue that has always been a source of conflict as a result of lack of congruence between the aspirations of the principals and the agents' pursuits (Bhimani, 2008). The theory basically separates ownership and control, although it does very little to eradicate misconduct.

## **2.3 Stewardship Theory**

Davis, Schoorman and Donaldson (1997) observe that the stewards who are the management team protect and maximises shareholder profits through firm performance and in the process, the stewards' value is maximized as well. The theory stresses on integrating goals of management, as stewards with that of the organisation. Management in this perspective, is satisfied and motivated by the attainment of success by the organisation. According to Daily, et al (2003) management, is likely to maximise financial position of the firm and shareholders' profits as it is given autonomy based on trust and as a way of improving personal careers. In this regard accountability and transparency is enhanced.

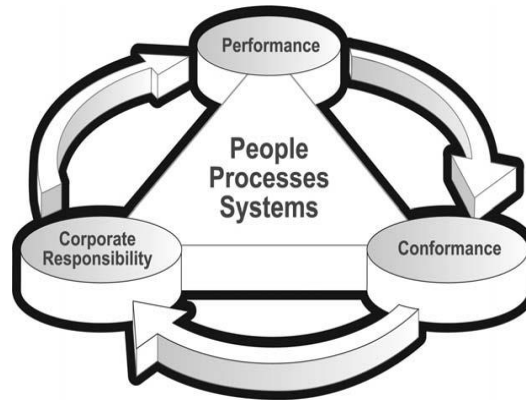
## **2.4 Stakeholders Theory**

Stakeholder theory is a further development on the concept of stakeholders and its relationship to any business corporation. Freeman (1984) offers a traditional definition of a stakeholder and says it is any group or individual who can affect or is affected by the achievement of the organization's objectives. The general idea of stakeholder theory is a redefinition of the organisation. The theory as noted by Friedman (2006) states that the organisation itself should be thought of as a grouping of stakeholders and the purpose of the organization should be

to manage their interests, needs and viewpoints. The managers should manage the corporation for the benefit of its stakeholders to safeguard the long-term stakes of each group. There is an emphasis on stakeholders and the governance structure of the company may provide for some direct representation of the stakeholders' groups. According to Friedman (2006), the main groups of stakeholders are: customers, employees, local communities, suppliers and distributors, shareholders, the media, general public, business partners, future generations, past generations' academics, competitors, non-governmental organisations, trade unions, competitors, regulators and governments. In order to achieve the overall corporate objectives, managers of business corporations need to understand, appreciate and conscientiously apply the propositions of stakeholders' theory. For every individual or groups that have stake in the organisation, effort must be made by the agents to preserve and protect the interests of stakeholders for the survival of the corporations.

The rising framework, under the three facets of Performance, Conformance and Corporate Responsibility, focuses the primary concerns that stakeholders such as boards and senior executives must in effect manage to ensure the delivery of long-term value to stakeholders (see Figure 1 below). Hussey and Sowinska (2000) argue that distinct from a lot of current management philosophy, that is mostly focused on the foundation that conformance links directly to responsibility, and performance to the creation of value. Corporate Governance clearly highlights that these two schools of thought are exchangeable.

**Figure 1. Corporate Governance Trend**



*Source:* Hussey and Sowinska: 2000.

Contextually conformance focuses on adherence to laid down procedures and standards, which corporate governance has as a governance system. For example, disclosure of financial statements from income statements, financial position statements including annual statements given at appropriate times will certainly give enough information to stakeholders who will in turn come up with informed decisions. The systems naturally become cyclic in nature each leading to the next due process. Conformance lead to implementation of corporate set objectives, which literally are the organizational responsibilities which, if well done will lead to measurable performance by the organisation.

## **2.5 Ethics Theory**

Ethical theory is a build-up on the concept of ethics in general. The term ethics comes from the Greek word “*ethos*” meaning morals. Morality is the whole of opinions, decisions and actions with which people express what they think is good or right. Business ethics is a study of business activities, decisions and situations where business wrongs and rights are addressed. Schofield (2006) notes that ethical theory sometimes focuses not on actions but majorly on consequences. The consequence of actions is measured against values such as happiness, welfare, high productivity and expansion. The cardinal point in this theory is that, it is essential to give the greatest happiness to the greatest number of people. Crane and Matten (2007) observed

that business ethics help to identify benefits and problems associated with ethical issues within the firm. The agents should make all efforts to ensure that principals have satisfactory values with regards to their investment. The actions of the agents will be adjudged morally right in the process of running the corporations on behalf of the owners if the latter's interest is well represented whereas it will be adjudged wrong if their actions inflict pain on the interest of the principals. Closely related to the ethics theory is *Corporate Social Responsibility (CSR)* which advocates for organizations and corporations to have an obligation to seek the interest of customers, employees, shareholders, communities and ecological considerations in all aspects of their operations. Jimi (2008) observes that presently, CSR is a family of concepts dealing with corporate philanthropy, corporate citizenship, community relations, community advocacy, corporate governance, accountability and transparency, corporate competence, corporate ethics, employee relations, human rights among other aspects. Corporates continually seek to grow their brands from all possible angles. Areas of focus include education, health, environment and the needy. Investment in these areas is usually in essential books, computerization of schools, giving medical equipment and building clinics, planting trees, and helping the needy through empowerment initiatives. The political front has its fair share of influence. The political theory, says politics can affect a firm in many ways, it can determine ownership, size, production trend, accessing capital, employees' conduct and even how authority is distributed inside the firm. (Roe, 2003). The organizational operational dynamics of how managers and employees relate to each is also influenced. Authority distribution is key and can be aligned to the political forces exerted on the firm. Chinese penetration into Africa is appropriate example in this regard.

## **2.6 Internal Governance**

### ***i. Boards of directors***

The corporate governance framework should ensure strategic guidance of the firm by the board which is dynamic with its fiduciary responsibility to shareholders. The board is the driving mechanism of the firm mainly responsible for monitoring managerial performance and achieving adequate return for shareholders. The board also works

to avoid conflict of interest and competing demands on the firm, and need to be impartial in their judgments. The board is also mandated to oversee the risk management factors and systems put in place to ensure compliance with laws affecting the firm, such as tax, competition ethics, labour, equal opportunity, health and safety. The board apart from being accountable to the firm and shareholders should also take due and fair regard of other stakeholders such as employees, suppliers, creditors' customers and the local community (Deli and Gillan, 2000).

Boards of firms are supposed to exhibit two very important elements of the fiduciary duty namely that of care and loyalty. The duty of care requires board members to be fully informed of the firm's operations. The duty of loyalty is underpinned on effective implementation of principles such as fair treatment of shareholders, remuneration policy of key executives and board members (OECD, 2015).

#### *ii. Managerial remuneration*

The remuneration policy of a company developed by the boards plays a fundamental role in aligning the interests of managers and owners. Recent work by Bebchuk and Fried (2003), advocate for equity based compensation which translate to remuneration closely related to performance. Specific terms to be observed by board members and key executives are clarified especially those to do with holding and trading the stock of the company and procedures to be followed in granting and re-pricing options. The remuneration policy and contracts is handled by a special committee of the board comprising either wholly or a majority of independent directors excluding executive members who serve on each other's remuneration committees, to avoid conflict of interest.

#### *iii. Audit Committees and Independent Directors*

According to Mangena and Taurigana (2004) corporate governance experts and regulators consider the audit committee as the body that is at the heart of the corporate reporting process. The Cadbury Code (1992) suggested that all companies should set up audit committees, and the Smith Report (2003) provided comprehensive direction on the role and responsibilities of the audit committee. Audit committee responsibilities comprise monitoring the financial statements of the company's integrity and reviewing internal control systems.



Forker (1992) argued that the existence of audit committees may improve internal control for effective monitoring and information disclosure.

## **2.7 External Governance**

### ***i. Laws/Regulations***

Firms have to abide by the regulatory and legislative requirements which are basically drawn from the host country's specific circumstances, history and tradition. The regulatory and legislative framework differs from country to country. The overall corporate performance is greatly influenced by regulatory and legal environment within which the firm operates. The policy makers in turn should put in place a framework that is flexible enough to meet the needs of the corporations operating in widely different circumstances. The overall impact of the laws or regulations binding the corporate governance framework should advocate for the rule of law and transparency (Jensen, 2001). This deals with the possibility of corporate fraud and issues to do with ethics. Corporate governance practices and requirements are bound by an array of legal aspects such as securities regulation, company law, auditing and accounting standards, insolvency law, contract law, labour and tax laws. Human rights and environmental laws are also very important as these affect the overall treatment of the environment and labour. Labour should be fairly remunerated, health and safety issues should be of paramount importance. Social responsibility by the firms should be viewed and implemented as a developmental gesture of appreciation to the community in which the firm operates. Board of directors and management should prioritize this crucial obligation in order to earn respect and support from host communities and host country at large.

### ***ii. Ownership Concentration***

In financial and general management positive agency theory put forward that a wider spreading of share ownership is related with greater transparency. Fama and Jensen, (1983) contends that the separation of control and ownership creates agency costs as a result of differing and conflicting interests between owners and management. Since agency costs are relatively high for organizations with dispersed ownership of shares, shareholders demand greater information

disclosure for monitoring purposes. The situation calls for strong corporate governance as transparency is reduced by ownership concentration.

### *iii. Foreign Ownership*

Strategic management scholars argue that when an organization goes international the uncertainty of a company's business operations and complexity increases. Stakeholders are then likely to place greater pressure on the company to ensure it implements effective monitoring mechanisms. According to Meek, Roberts and Gray (1995) multinational organisations' performance, behavior and consequences of their operations are closely monitored by international government agencies and political pressure groups. As a result, foreign investors are required to comply fully with all regulatory and statutory requirements of the host countries for their international subsidiaries. International subsidiaries will probably have more complicated financial reporting systems that facilitate greater disclosure in their end of year reports compared to local companies. There is indication of positive correlation between foreign ownership and corporate disclosure as established in recent studies by Haniffa and Cooke, (2002).

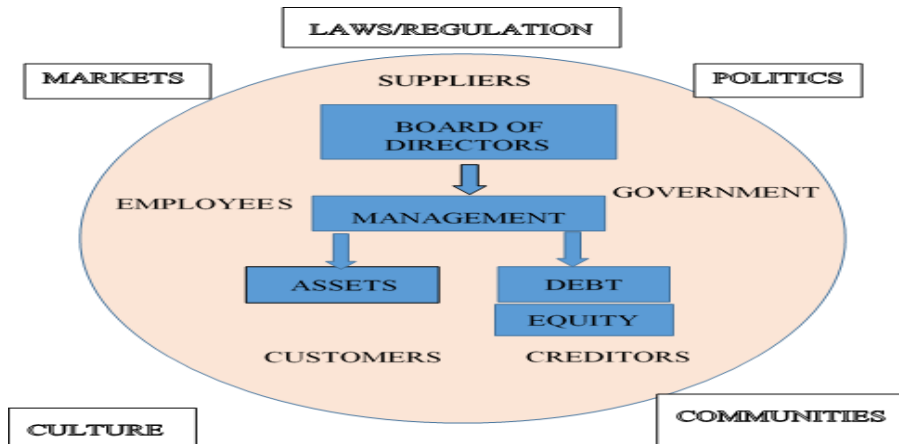
### *iv. Cross Directorships*

Cross-directorships refer to a situation where executive directors and non-executive directors sit on more than one board. Recent studies have acknowledged that situations where directors are members of more than one board poses greater implications on the governance functions, considering the independence of directors in a unitary and compound board. Davis (1996) is of the view that cross directorships put companies at a competitive disadvantage considering that, their existence on more than one board will make them less independent as they will be more sympathetic with others in similar positions. Those against cross-directorships argue that directors on more than one board are devices for interoperate conspiracy, benefit control over corporate decision-making and for the summation and development of the collective interests of the corporate leaders (Useem, 1984). Opponents of cross-directorships argue that when a director is actively involved in more than one board it compromises the confidentiality and

information disclosure of a company (Haniffa & Cooke, 2002). Unitary boards in this case are recommended for effective decision making.

### 3. ONE FUSION CORPORATE GOVERNANCE FRAMEWORK

Figure 2. The corporate governance framework



Source: Gillan: 2006.

The review of corporate governance from various theories brings about a structure that is based on social relationships underpinned by well-defined processes. The outcomes of the agency theory, stewardship theory, stakeholder theory, ethical theory, corporate social responsibility theory and the political theory bring about a hybrid corporate governance framework. The fusion of the aspects drawn from the theories addresses the cause and effect of the variables. The configuration of each group of people in the corporate governance matrix is clearly enunciated. The role of shareholders, board of directors, management, employees, among others. The framework above outlines the groups. The agency theory, illustrated by the board of directors playing its fiduciary function over management. Management in turn should ensure that all stakeholders' concerns are given due consideration. The board of directors' due attention to other critical issues such as legislation, culture, communities it operates

under, markets and politics makes the stewardship theory visible and relevant. This shows that corporate governance is dynamic and ever changing driven by both internal and external environmental dynamism. The internal environment is driven by shareholders' relationship with stakeholders in maximizing profits. On the other hand, the external environment is all about easier financing, business collaborations, mergers, acquisitions, globalization and advanced communication and information technology. These developments have brought changes to corporate governance. Governance has to take into consideration the variance of cultural values, political, social and historical circumstances. This means corporate governance in developed and developing countries has to differ taking the contextual implications of each country. From the model given above no one theory can fully outline corporate governance but it requires a combination of variables from each of them.

#### **4. CONCLUSION**

It is worth noting that the paper gives an outline of governance issues that are pertinent to the deeper understanding of the tenets of corporate governance. The issues addressed are consistent with contemporary governance mechanisms. The composition, structure and functions of the various players was clearly outlined led by a board of directors with stewardship values. A combination of the tenets of various theories created an ideal corporate governance framework. The emerging corporate governance framework referred to as the *One Fusion Corporate Governance Framework* is envisaged to ultimately influence the performance of organizations particularly parastatals and private institutions in Zimbabwe. Research work undertaken by several scholars through such theories as agency theory, stakeholders' theory, stewardship theory, social corporate responsibility theory and political theory indicate that no one theory can enunciate the ideal corporate governance mechanism. A combination of social relationships and laid down regulations, bound by legislation produce a corporate governance framework that enhances and recognizes stakeholders, ethics of the firm and fair judgement leading to improved organizational performance. Globalization and information technology now requires more accountability that can be facilitated by the proposed model. It should be borne in mind that even with strict adherence to regulations there have been infringements of governance procedures.

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