Theories and models of Corporate Governance

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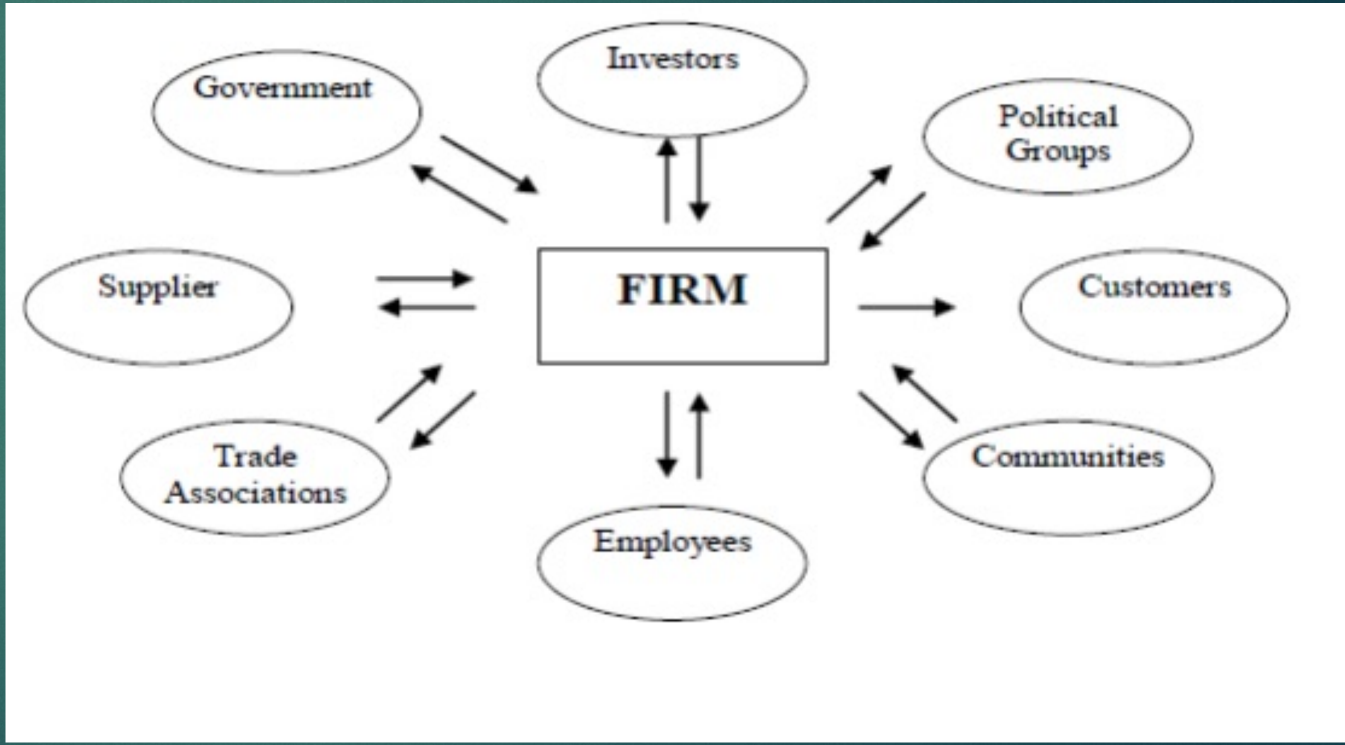
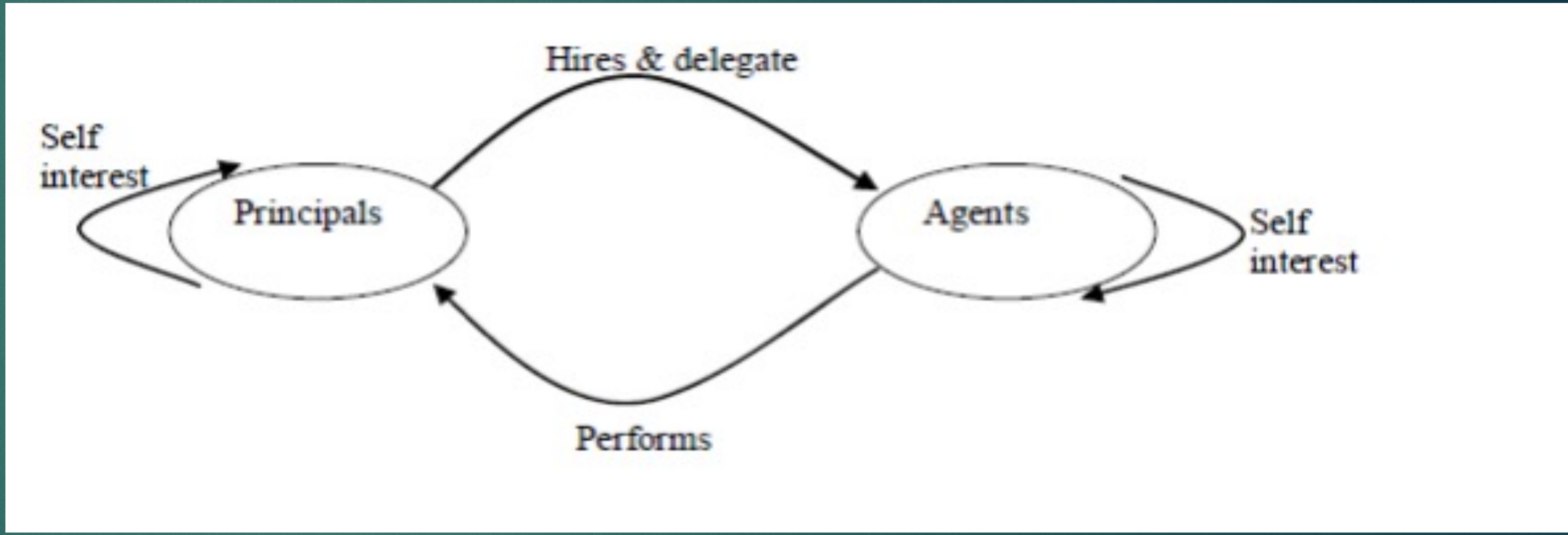
Stakeholder Theory

Stakeholder theory incorporated the accountability of management to a broad range of stakeholders. It states that managers in organizations have a network of relationships to serve – this includes the suppliers, employees and business partners. The theory focuses on managerial decision making and interests of all stakeholders have intrinsic value, and no sets of interests is assumed to dominate the others



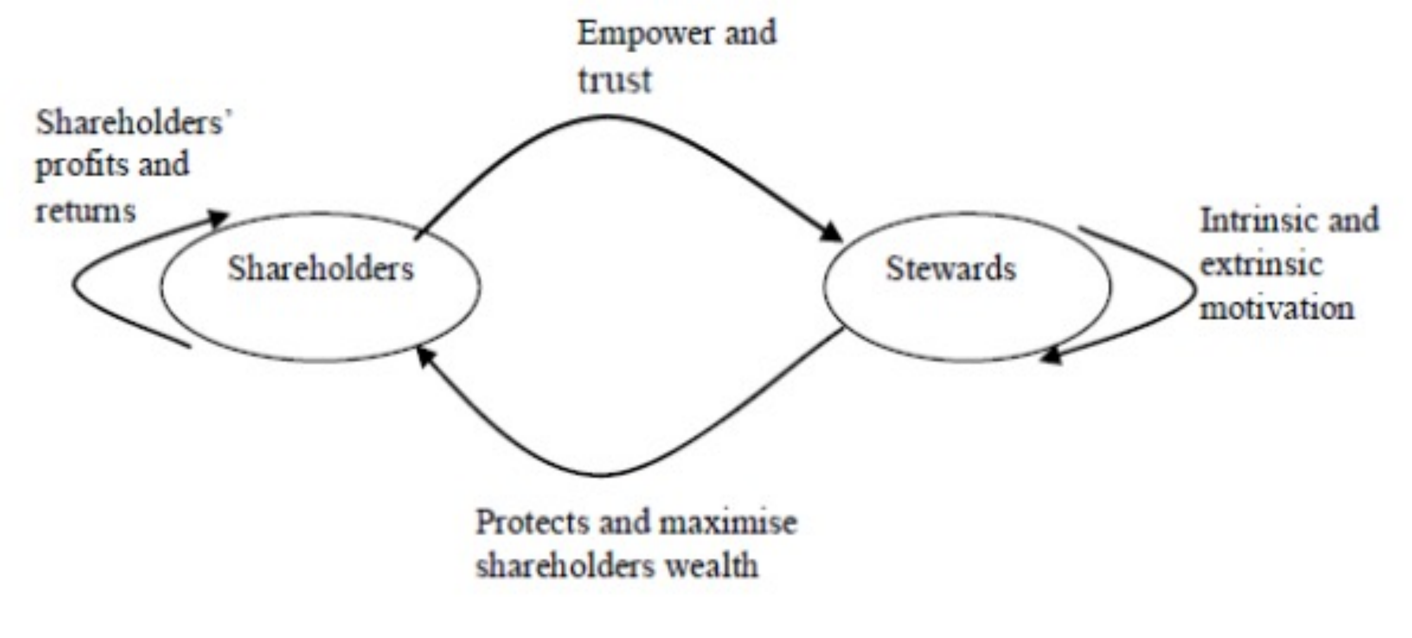
Agency Theory

Agency theory defines the relationship between the principals (such as shareholders of company) and agents (such as directors of company). According to this theory, the principals of the company hire the agents to perform work. The principals delegate the work of running the business to the directors or managers, who are agents of shareholders. The shareholders expect the agents to act and make decisions in the best interest of principal



Stewardship Theory

The steward theory states that a steward protects and maximises shareholders wealth through firm Performance. Stewards are company executives and managers working for the shareholders, protects and make profits for the shareholders. The stewards are satisfied and motivated when organizational success is attained.



Other theories of CG

Resource Dependency Theory	Transaction Cost Theory	Political Theory	Enlightened Shareholder Theory
The RDT is developed by the American business theorist Jeffrey Pfeffer and the American organizational theorist Gerald R. Salancik in the year of 1978 at the Stanford University according to Delke (2015). The procurement of external resources is an important tenet of both the strategic and tactical management of any company therefore the Resource Dependence Theory (RDT) [American business theorist Jeffrey Pfeffer and American organizational theorist Gerald R. Salancik]	Hennart et al (2010) state that transaction cost theory tries to explain why companies exist, and why companies expand or source out activities to and from the external environment. The transaction cost theory supposes that companies try to minimize the costs of exchanging resources with the environment, and that companies try to minimize the bureaucratic costs of exchanges within the company. This is when the compliance and ethics comes in.	Political theory brings the approach of developing voting support from shareholders, rather by purchasing voting power. It highlights the allocat ion of corporate power, profits (and privileges are determined via the governments' favour) []	the first obligation of board members to become clear at all times to defend the corporate's long-term social interests thus clarifying the duties of board members while giving them chance to exercise control and ownership. [Pichet (2011)]

Models of Corporate Governance

- Anglo-American Model
- The German Model
- The Japanese Model
- Social Control Model
- Canadian Model
- UK and American Model
- Italian Model
- French Model
- Indian Model (not included in the slide; will be discussed separately after an assignment)

Anglo-American Model

- Under the Anglo-American Model of corporate governance, the shareholder rights are recognised and given importance. They have the right to elect all the members of the Board and the Board directs the management of the company. Some of the features of this model are:
  - This is shareholder oriented model. It is also called Anglo-Saxon approach to corporate governance being the basis of corporate governance in Britain, Canada, America, Australia and Common Wealth Countries including India
  - Directors are rarely independent of management
  - Companies are run by professional managers who have negligible ownership stake. There is clear separation of ownership and management.
  - Institution investors like banks and mutual funds are portfolio investors. When they are not satisfied with the company's performance they simple sell their shares in market and quit.
  - The disclosure norms are comprehensive and rules against the insider trading are tight
  - The small investors are protected and large investors are discouraged to take active role in corporate governance.

Anglo-American Model

- In July 2002, the U.S. Congress passed the Sarbanes Oxley Act (SOX), particularly designed to make US corporations more transparent and accountable to their stakeholders.
- The Act seeks to re-establish investor confidence by providing good corporate governance practice to prevent corporate scams and frauds in business corporations, to improve accuracy and transparency in financial reporting, accounting service of listed companies, enhance corporate responsibility and independent auditing.

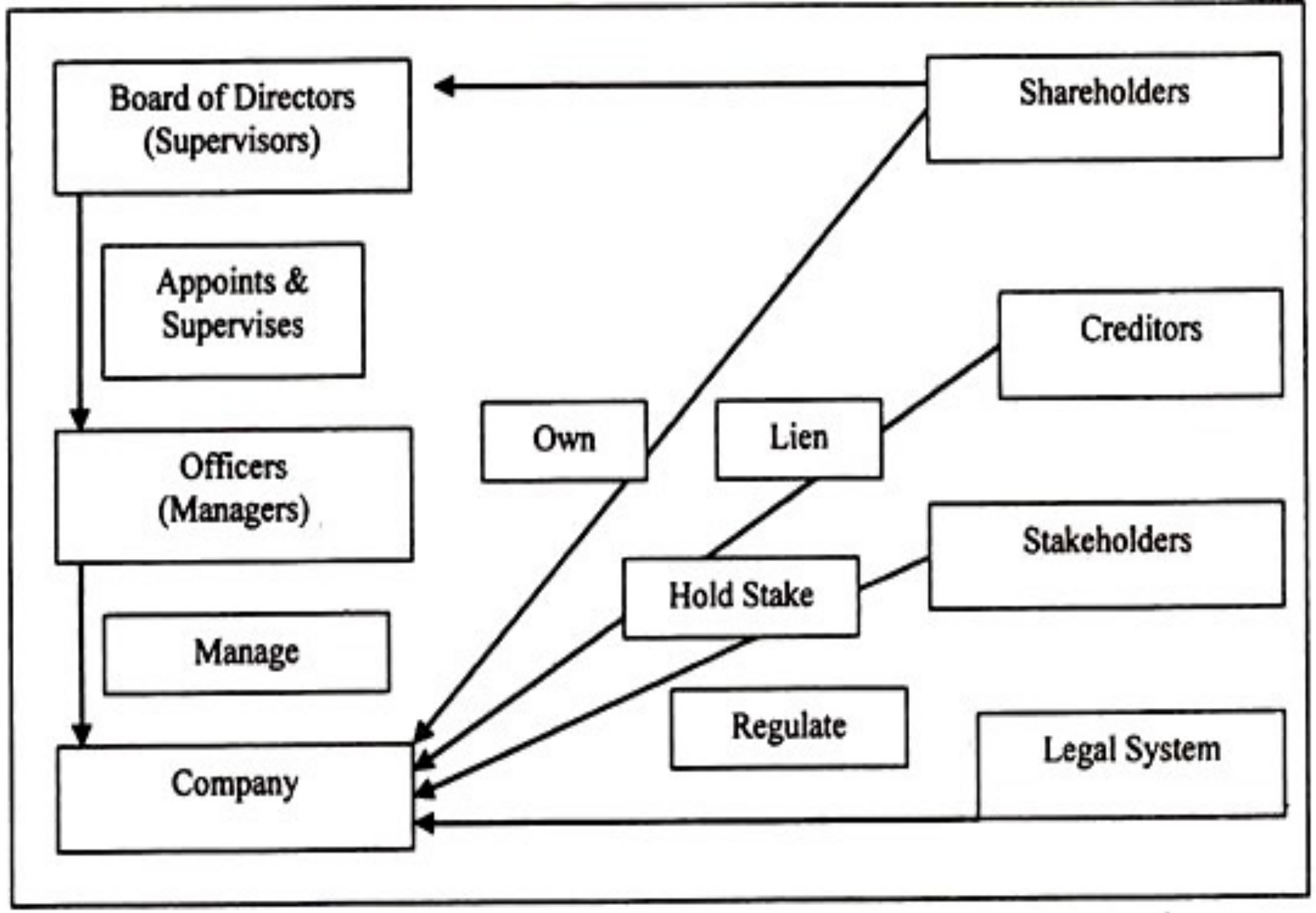


FIG. 2.1 : THE ANGLO-AMERICAN MODEL

German Model

- Germany is known for industrialisation since beginning of 19th century. Germany exports sophisticated machinery in a large way since last five decades. The industries are financed by wealthy German families, small shareholders, banks and foreign investors. The large private bankers who invested in industry had a bigger say in running those industries and hence performance was not up to the mark.
- This is also called *European Model*. It is believed that workers are one of the key stakeholders in the company and they should have the right to participate in the management of the company.
- Germany is considering proper steps towards corporate governance since second half of 19th century.
- The **company law in Germany of 1870** created dual board structure to care of small investors and the public. The company law in 1884 made information and openness as the key theme. The law also mandated minimum attendance at the first shareholders meeting of any company.
- World War I saw considerable changes in industries in Germany by dismantling the rich. As on date Germany has large number of family controlled companies. The smaller companies are controlled by banks. The proxy voting by small investors was introduced in Germany in year 1884.

German Model

- The corporate governance is carried out through two boards, therefore it is also known as two-tier board model. These two boards are:
  - **Supervisory Board**: The shareholders elect the members of Supervisory Board. Employees also elect their representative for Supervisory Board which are generally one-third or half of the Board.
  - **Board of Management or Management Board**: The Supervisory Board appoints and monitors the Management Board. The Supervisory Board has the right to dismiss the Management Board and re-constitute the same.

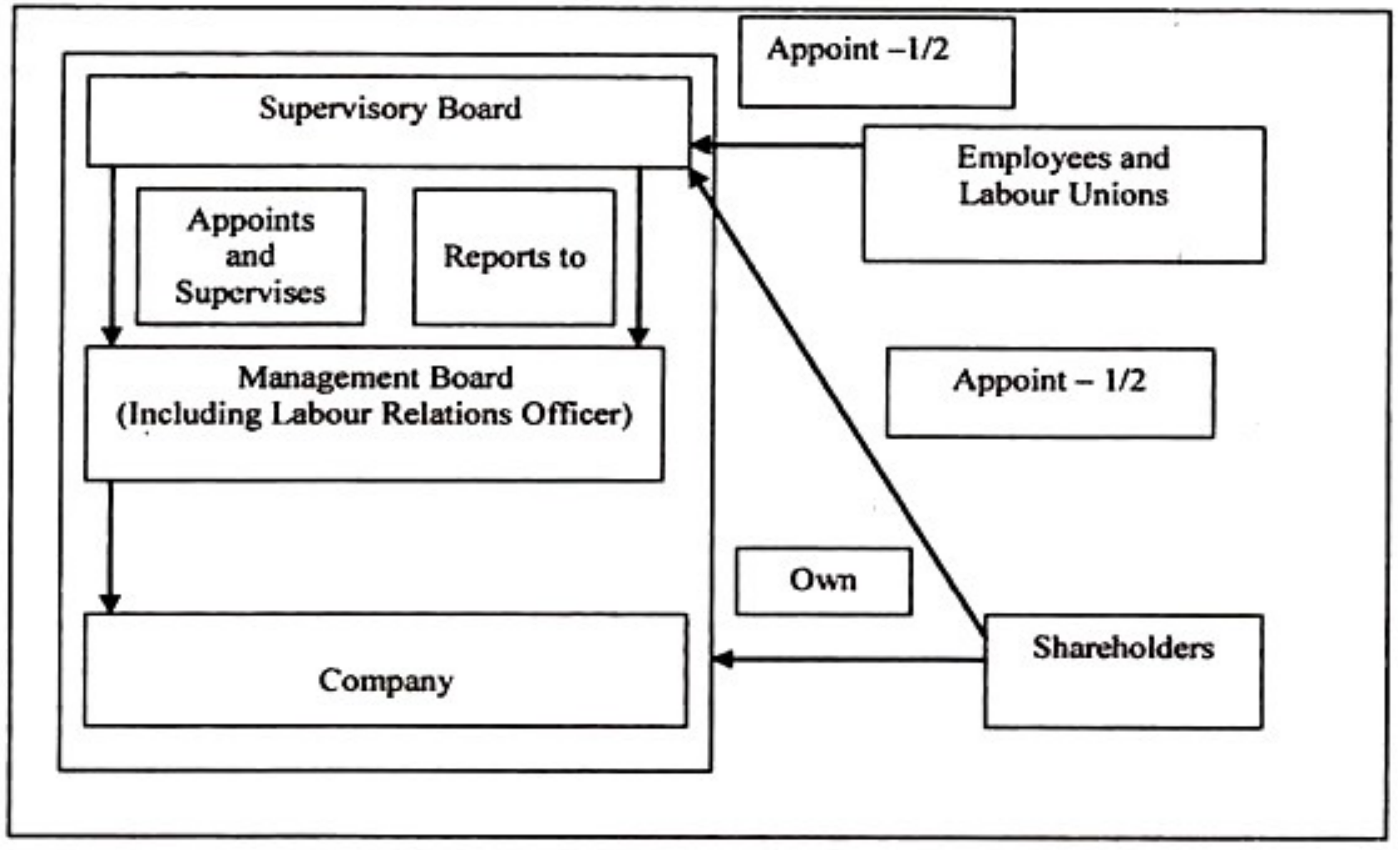


FIG. 2.2: THE GERMAN MODEL

Japanese Model

- Japan was a deeply conservative country were the hereditary caste system was important. Business families where at the bottom of the period i.e., beneath priests, warriors, peasants and craftsmen. Due to lack of funds at the lowest level of the pyramid led to the stagnation of the business.
- The World War II brought a sea change in the business, commerce and industry and opened the Japanese markets to the American traders.
- The government also started establishing stated owned companies. These companies ended up in losses and huge debts. To come out of the problem the government made mass privatization of most of these companies. Many of these were sold to Mitsui and Sumitomo families.

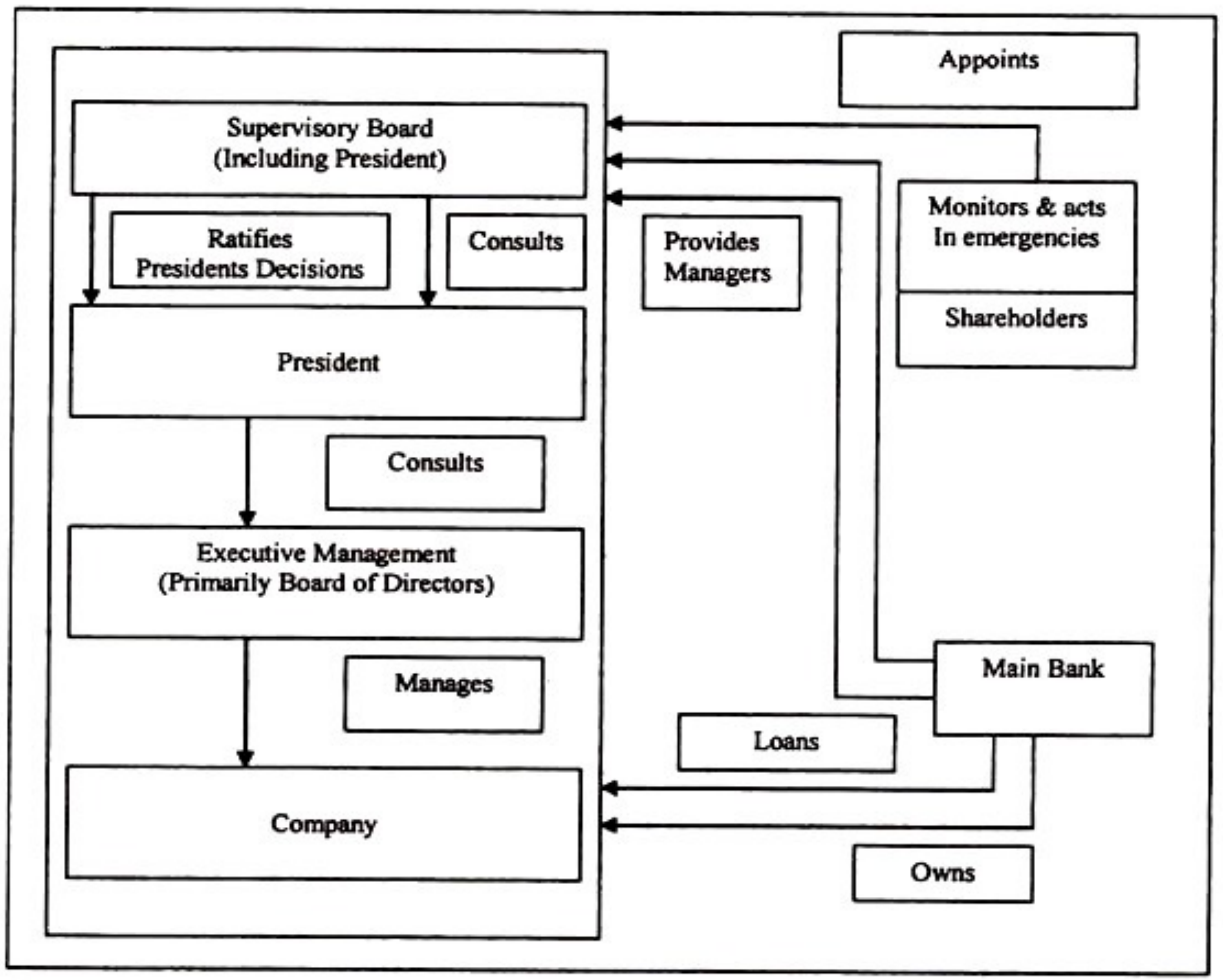


FIG. 2.3: THE JAPANESE MODEL

Japanese Model

- The young Japanese started taking higher education in Europe and America and learnt foreign technology, business management.
- Japanese companies raise significant part of capital through banking and other financial institutions.
- Since the banks and other institutions stakes are very high in businesses, they also work closely with the management of the company.
- The shareholders and main banks together appoint the Board of Directors and the President. In this model, along with the shareholders, the interest of lenders is recognised.

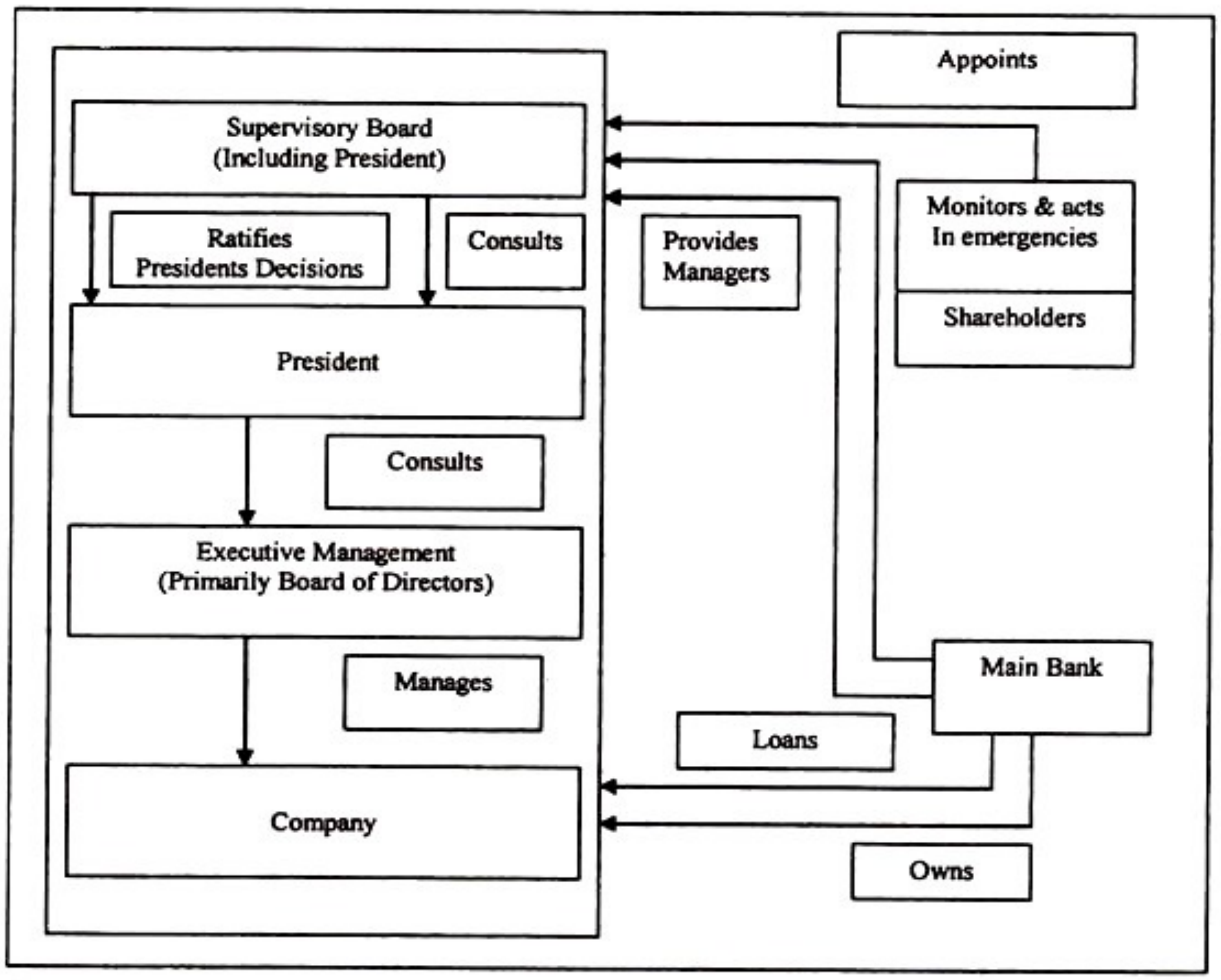


FIG. 2.3: THE JAPANESE MODEL

Social Control Model

- Social Control Model of corporate governance argues for full-fledged stakeholder representation in the board.
- According to this model, creation of Stakeholders Board over and above the shareholders determined Board of Directors would improve the internal control systems of the corporate governance.
- The Stakeholders Board consists of representation from shareholders, employees, major consumers, major suppliers, lenders etc.

Canadian Model

- Canada has a history of French and British colonisation. The industries inherited those cultures. The cultural background in these industries affected subsequent developments. The country has large influence of French merchantism.
- In 19th century the Canadian industries were controlled by rich families. Since last five decades wealthy Canadian families sold their stocks during stock boom periods. Canada now resembles United States in industry structure.
- **Since last four decades there is change in industries in Canada in the areas:**
  - *Family owned companies are on the increase*
  - *Use of new technologies*
  - *More entrepreneurial activities*
  - *Early entrance in initiating corporate governance*
  - *Diffuse ownership from earlier colonial masters.*

French Model

- The French financial system traditionally was regulated by the religion. T
- he controlling methods, borrowing and lending with the state constituting the main borrower.
- Religion had prohibited the interest to some extent. The lending was based on mainly mortgages of real estates. In early 19^{th} century the French public took to hoarding gold and silver.
- Coins composed measure part of money transactions in that period. The French industry was conservative in its outlook.
- The business used the retained earnings of one company to build other areas of business and companies.
- The business was controlled by wealthy families who funded these business groups. The control of the company continued from generation to generation.
- Stage wise the corporate government was introduced in France along with economic development activities. This led to wealthy families controlling corporate sector to come under the watchful guidance of the state.