Corporate Governance & Audit Archive Review

E-ISSN: 3006-144X
P-ISSN: 3006-1431

Corporate Governance Protects Stakeholder Rights and Interests: An Agency Theory Perspective

Shahid Khan
Ms Scholar department of Economics of COMSATS University Islamabad
Sarwar Jalal
Ms Scholar department of Economics of COMSATS University Islamabad

ABSTRACT | *The article applies a comprehensive method to defend stakeholders' rights and interests through corporate governance (CG). It explores whether boards of directors who effectively represent shareholder interests also protect the interests of the organization's other stakeholders. It explores how corporate governance should be established for already operating corporations, especially in line with arbitrary fairness and impartiality requirements. The notion of corporate governance (CG) is defined and clarified via the use of the Organization for Economic Cooperation and Development's (OECD) governing principles and guidelines. Nigeria, the United States, and the United Kingdom, according to reports, developed their corporate social responsibility (CSR)-oriented CG principles in consultation with the OECD principles and other sources of CG rules and principles, such as the Companies and Allied Matters Act, the Investment and Securities Act, and numerous others. It asserts that the concept of corporate governance (CG) is applicable to corporate businesses worldwide by emphasizing the importance of defining the rights and responsibilities of various corporate stakeholders, such as board members, managers, and shareholders, as well as decision-making guidelines and processes. Furthermore, this enables the organization's objectives to be established, the road to reaching them determined, and outcomes monitored. While acknowledging that corporate governance (CG) is an important problem for organizations, the paper contends that because an organization cannot please all stakeholders, it is preferable to create a compromise between accomplishing organizational aims and those of the stakeholders.*

KEYWORDS | *Corporate Governance, Stakeholder Rights and Interests agency*

How to Cite
Shahid Khan, & Sarwar Jalal. (2024). Corporate Governance Protects Stakeholder Rights and Interests: An Agency Theory Perspective. Corporate Governance &Amp; Audit Archive Review, 2(01), 56–64. Retrieved from http://cgareview.com/index.php/Journal/article/view/29

INTRODUCTION

Agency theory has grown increasingly closely tied with the shareholder paradigm of corporate governance since the advent of organizational ownership and control separation. As a result, the

VOLUME 02
ISSUE 01 (2024)

concept of stakeholders has gained significant significance in the sphere of corporate governance (CG). According to this notion, managers operate as the owners' (or shareholders') representatives and are expected to work in the best financial interests of the corporation's shareholders (Monks & Minow 2004). A broader definition of business that only includes firms that promote the financial interests of their investors is insufficient. Corporate laws have continually integrated stakeholders' perspectives. One of the main ideas is the creditor protection strategy, which demonstrates this. Nonetheless, stakeholders have lately expressed a more comprehensive and forward-thinking perspective. This project aims to promote proactive corporate participation in defending the interests of non-shareholder groups such as suppliers, employees, and others, with the goal of enhancing their well-being. In light of the aforementioned, this research seeks to investigate CG in the context of corporate social responsibility (CSR) and stakeholder protection in corporate enterprises. This is achieved by outlining the decision-making norms and procedures and highlighting the need of properly identifying the rights and obligations of various corporate members, such as shareholders, board members, managers, and other stakeholders. It also looks at how the company defines its goals, implements them, and tracks success.

2. An Examination of the Literature

According to Emmon and Schmid, quoting Shleifer and Vishny, corporate governance guaranteed that shareholders received a reasonable return on their investments; without it, external investors would not lend to the corporation or acquire its stock instruments. As a result, the company would be forced to rely on money produced internally. Furthermore, they claimed that the political and legal environments have a significant impact on corporate governance, which increases company performance globally (Emmons & Schmid 1999, Shleifer & Vishny 1997). Corporate governance and organizational success are thus inextricably linked to investor protection and the legal system's integrity. Mehar investigated corporate governance and dividend policy. According to Mehar (2003), the payment of dividends is critical, and in some economies, firms are required to do so through the use of external finance. According to Abdullah and Valentine, the core ideas of corporate governance arose from a study of agency theory, which was then expanded to include stewardship theory, stakeholder theory, business and virtue ethics, resource dependency, and transaction costs. Rather than the legal framework, these theories investigate the origins and consequences of factors such as the makeup of the board, audit committee, independent director, and senior management, as well as their interpersonal relationships. Instead of focusing on a single theory, they determined that integrating various theories would be the most effective method to defining outstanding governance practices (Abdullah & Valentine 2009). In a similar vein, Kajola used the panel method and ordinary least squares estimate techniques to investigate the relationship between business performance and corporate governance procedures. His findings supported the presence of a significant and positive relationship between corporate governance structures and organizational performance measures (Kajola 2008). According to Odaki and Kodama, economic institution theories support the idea that there is a beneficial relationship between corporate governance and human resource investment. Odaki and Kodama (2010) hypothesized a link between a company's ownership and management structure, employee training and remuneration, and human capital investment.

3. Fundamentals of Corporate Governance

The Cadbury Report (United Kingdom, 1992) was the first to emphasize the CG principle. The construction of strong corporate governance for Nigerian firms was based on the Organization for Economic Cooperation and Development (OECD) standards of corporate governance. The fundamental principles are as follows: board members must have extensive knowledge, act ethically and in good faith, and act with reasonable diligence and caution in the best interests of the organization and its shareholders; supervise significant acquisitions and diversifications; choose, remunerate, monitor, and replace key executives; direct succession planning; and ensure a formal and transparent procedure for nominating and electing board members. A number of nations have established CG norms and principles based on the OECD principles. The OECD's shareholder rights and equitable treatment, the board's role and responsibilities, integrity and ethical conduct, disclosure and transparency, and interest in other stakeholders such as creditors, employees, suppliers, local communities, customers, and government are among the principles that the United States has embraced (United States 2002). The most recent revision to the country's CG legislation, the 2010 legislation of Corporate Governance, enhanced the UK Stewardship Code 2010. The code defines several fundamental elements of corporate governance, including a unified board that bears collective responsibility for the organization's long-term prosperity, robust mechanisms for oversight and accountability, enforceable rights for shareholders encouraging them to engage with the companies in which they invest, an appropriate distribution of independent and executive non-executive directors, autonomous audit and compensation committees, and enforceable rights for shareholders encouraging them to engage with the companies in which they invest. The Securities and Exchange Commission Rules (2013), the Companies and Allied Matters Act of 2004, the Investment and Securities Act of 2007, the Bank and Other Financial Institutions Act of 2004, the Insurance Act of 2004, the Code of Corporate Governance for Nigerian Public Companies, the Code of Corporate Governance for Nigerian Insurance Companies, and the Code of Conduct for Capital Markets. The Companies and Allied Matters Act (CAMA) governs the CG sector in Nigeria. The paper discusses several approaches that encourage good corporate governance. These include the company's process for appointing directors, the ordinary resolution process for removing them, the directors' obligations and liabilities, provisions for auditors and the audit committee, disclosure requirements, and shareholder participation in specific corporate decision-making processes.

4. Internal and External Parties Involved

Multiple groups of people have significant influence over CG and hold significant responsibilities. Within the organization, these separate groups are labeled as internal and external, respectively. Participants included... The following is the authority structure of the organization's internal groups: management oversees daily operations; shareholders, as the company's owners, are primarily concerned with ensuring that their investment in the business generates maximum returns and benefits; and the board of directors, who serve as shareholder representatives to direct the organization's affairs (Wogu 2019). Employees or staff of an organization are examples of external groups of people. The human resources that a company utilizes to help it achieve its goals and objectives are referred to as "clientele," which includes the customers who are the foundation of the business. Investors are individuals or groups capable of investing capital in a company; creditors, who provide funds for growth and expansion; suppliers, who provide the company with the diverse inputs it needs to function efficiently; and investors, whose needs the company can profitably satisfy. The aforementioned resources may include financial capital, technological advancements, human capital, and more; government regulatory authorities, which include a cohort endowed with governmental-granted powers to establish laws and regulations and oversee business operations; and the host community, which includes the local populace and surrounding area where the corporation is located. According to the OECD Principles of CG (2004), the CG framework should protect stakeholders' legal or mutually agreed-upon rights and encourage proactive cooperation between corporations and stakeholders in order to generate prosperity, job opportunities, and the long-term viability of financially stable enterprises. A company must be accountable not just to its customers but also to its shareholders. Due to resource limits, it is suggested that companies must identify their major stakeholders and then build a governance structure that balances the interests and demands of stakeholders with those of the company (Ferrell, Fraedrich, & Ferrell 2005). Prioritizing its stakeholders allows a corporation to make strategic decisions about how to manage those relationships. This may be performed by identifying and categorizing stakeholders based on their power and clout inside the company. According to Kazmi (2008), an organization may identify the relevance of stakeholders by evaluating the effect and type of each stakeholder's support or resistance.

5. Stakeholders' Role in Corporate Governance

Stakeholders, according to Donaldson and Preston, are any group with a vested interest in the organization, regardless of whether the organization itself has a functional interest in them. As a result, the company's stakeholder-centered approach is the idea that "each group of stakeholders merits consideration for its own sake and not merely because of its ability to further the interests of some other group, such as shareowners" (Donaldson & Preston 1995). While Freeman (1994) defines a stakeholder as "any group or individual who has the ability to influence or is influenced by the organization's objectives" (Freeman, 1994), theorists frequently aim to focus their attention on the most powerful actor groups within a particular context. Carroll (1979) restricts the definition of a stakeholder to persons or entities with a moral or legal right to the organization's choices. Furthermore, Blair, Aguilera, and Jackson suggest that only parties having a strong commitment in a given business should be allowed to engage in corporate governance debates (Blair, 1995; Aguilera & Jackson 2003). External stakeholders cannot be dismissed as insignificant to a company because of the multiple responsibilities they perform and the effect they have on its operations. Corporate governance (CG) is defined by John and Senbet (1998) as the mechanisms by which shareholders of a business utilize their power to guarantee that their interests are protected against those of the company's insiders and management. As a result, firms must have a full awareness of stakeholders' legal rights. In addition to actively interacting with its constituents, the organization should endeavor to construct a profitable operation, produce income, and create jobs. After establishing the value of constituents to the business, it is critical to illustrate the role they play in supporting strong corporate governance. According to Freeman (2008), the way stakeholders interact with CG can give insight into the crucial issue of how to effectively manage stakeholder relationships and define the priorities that govern those interactions. Because of their association with the firm and the effect they have on its operations, interests, and concerns, stakeholders are crucial to an organization's engagement process (Zollinger, 2009). The author further posits that these roles include but are by no means limited to the following: Experts that knowledgeable experts in diverse fields of endeavour are useful in offering strategic advice to the company’s board when invited, Technical Advisers are individuals who possess expertise in technological and scientific developments can offer well informed advice on scientific and ethical panels on the social and environmental risks associated with such developments especially in science-related industries, representatives of special interests: the review of company performance and of reporting practices can be carried out by its employees, local communities etcetera as they meet as stakeholders panel upon invitation, Co-implementers as this situation arises when an external body for instance a Non-Governmental Organization (NGO) partner with the company to jointly provide solution to an issue or address a shared challenge and co-monitor as this situation arises when the impacted communities having entered an agreement with the company become jointly responsible for the monitoring of the company's sustainability projects (Ibid).

5. Stakeholder Fundamentals

(Berle & Means, 1932) Shareholders have traditionally been recognized as the proprietors of a corporation in common law nations. This may be seen underneath the United Kingdom. According to Articles 16, 112, and 113 of the Company Act 2006, company law designates corporations as shareholders and classifies shareholders as "members." In reality, the collective of stockholders is often referred to as the "business," exemplifying the identity concept that corporations and their shareholders fundamentally share. The shareholders have the ability to nominate and remove corporate directors. Minority shareholders, who are distributed and are not regarded proprietors in the traditional sense, might be viewed as stakeholders whose interests are influenced by decisions made by controlling shareholders and higher management. Indeed, as previously stated, a number of CG requirements, such as those governing transparency and accounting integrity, are explicitly designed to safeguard non-controlling shareholders (and creditors). Under the law, co-owners are typically entitled to assurances about one another. As a result, imposing such limits may not impede the establishment of agreements forming a firm, but rather assist other stakeholders, such as creditors, the Inland Revenue, and taxpayers, by ensuring discipline and prohibiting ex-post opportunistic behavior. For generally known reasons, contestability of corporate control is seen as a device to protect the interests of non-controlling shareholders and increase resource efficiency. The regulations that allow non-controlling shareholders to profit from the firm's potential profitability by selling their shares to a bidder in public tender offers are widely recognized for their goal of reducing excessive instability in corporate management and a proclivity toward excessive short-termism (e.g., managers who rely excessively on volatile stock market conditions rather than long-term strategic planning). These laws, however, may inadvertently foster excessive short-termism. As is often the case, trade-offs take precedence over clear answers.

6. Shareholders and CS

The shareholder primacy argument, a common idea in English corporate law, illustrates one side of the discussion (Davies & Worthington 2012). In this context, it is generally acknowledged that the primary goal of enterprises is to maximize financial advantages for their owners (Friedman 2002). Proponents of this viewpoint argue that a corporation has already made a good contribution to society by offering a vital product or service at a reasonable price (Gelter 2011). Given that shareholders have made an investment and rely on the firm to earn a return, spending shareholder cash for useless social goals is judged pointless and irresponsible (Carroll 1979). The Michigan Supreme Court created the legal foundation for the shareholder primacy approach in the case of Dodge v. Ford Motor Company in 1919. This theory's main goal is to ensure that corporate directors govern firms with the only motive of enhancing shareholder value, providing that their duties and objectives are restricted to economic considerations (Friedman 2002). The court concluded that the primary goal of forming and maintaining a business corporation is to maximize profits for investors. As a result, the board of directors has the legal authority to take any action that may raise the capital of the proprietors (Friedman 1962). As a result, this method avoids CSR, which forces directors to take into account the interests of other stakeholders when making decisions. The term implies that this approach is entirely concerned with the interests of investors. Furthermore, this indicates that the interests of shareholders take precedence, with the advantages or concerns of other stakeholders being secondary. However, while making decisions, corporate directors consider the benefits and concerns of other stakeholders, as long as such consideration does not jeopardize shareholder wealth. Indeed, proponents of this approach believe that, as opposed to shareholders, the rights and interests of other stakeholders are secured and preserved by contractual arrangements with the organization (Jensen 2002).

Conclusion

When it comes to corporate enterprises, CG is a critical topic that should not be overlooked or minimized.This is because good CG adds to the organization's long-term profitability and efficiency.External constituents, who acknowledge their significant effect on the organization, are a vital component. To devote its attention to those stakeholders who are strategic to the business, the corporation should identify the major stakeholders by analyzing their level of influence and power. Recognizing the inherent problem of pleasing every stakeholder is vital; thus, it is best to identify a middle ground that reconciles the pursuit of company objectives with the interests of stakeholders.

References

- Abdullah, H., & Valentine, B. (2009). Fundamental and Ethics Theories of Corporate Governance. Middle Eastern Finance and Economics, No. 4, 88-96.
- Aguilera, R., & Gregory, J. (2003). The Cross-National Diversity of Corporate Governance: Dimensions and Determinants. Academy of Management Review, 28, 447-465. https://doi.org/10.5465/amr.2003.10196772
- Berle, A. A., & Means, G. C. (1932). The Modern Corporation and Private Property. New York: Macmillan.
- Blair, M.M. (1995). Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century. Washington DC: The Brookings Institution.
- Carroll, A. B. (1979). A Three Dimensional Conceptual Model of Corporate Performance. Academy of Management Review, 4, 497-498. https://doi.org/10.5465/amr.1979.4498296
- Code of Corporate Governance for Banks and Discount Houses in Nigeria, and Guidelines for Whistle Blowing in the Nigerian Banking Industry (2019). http://www.ecgi.org/codes/code.php?code_id=416 Code of Corporate Governance for Public Companies in Nigeria (2019). http://www.sec.gov.ng/code-of-corporate-governance-.html
- Coffee, J. C. (1998). Inventing a Corporate Monitor for Transitional Economies: The Uncertain Lessons From the Czech and Polish Experiences. In K. J. Hopt et al (Eds.), Comparative Corporate Governance: The State of the Art and Emerging Research (pp. 67-138). New York: Oxford University Press.
- Collier, J., & Robberts, J. (2001). An Ethic for Corporate Governance? Business Ethics Quarterly, 11, 67-71. https://doi.org/10.5840/beq20011117
- Davies, P. L., & Worthington, S. (2012). Gower and Davies Principles of Modern Company Law (pp. 502-560). London: Maxwell. Donaldson, T., & Dunfee, TW. (1999). Ties that Bind: A Social Contracts Approach to Business Ethics (Chapter 9). Boston, MA: Harvard Business School Press.
- Donaldson, T., & Preston, L. E. (1995). The Stakeholder Theory: Concepts, Evidence and Implications. Academy of Management Review, 20, 65-91. https://doi.org/10.5465/amr.1995.9503271992
- Emmons, W. R., & Schmid, F. A. (1999). Corporate Governance and Performance. Working Paper 1999-018A. Federal Reserve Bank of St. Louis. https://doi.org/10.20955/wp.1999.018
- Evan, W. M., & Freeman, R. E. (1988). A Stakeholder Theory of the Modern Corporation: Kantian Capitalism. In T. L. Beauchamp, & N. E. Bowie (Eds.), Ethical Theory and Business (3rd ed., pp. 97-106). Upper Saddle River, NJ: Prentice-Hall.
- Odaki, K., & Kodama, N. (2010). Stakeholder-Oriented Corporate Governance and Firm-Specific Human Capital: Wages Analysis of Employer-Employee Matched Data (pp. 1-21). Research Institute of Economy, Trade and Industry Paper Series 10-E-014.
- Oladimeji, A. (2007). Corporate Governance in Nigeria: An Overview. CBN Bullion, 31, 1-6. Oman, C. P. (2001). Corporate Governance and National Development, An Outgrowth of the OECD Development Centres Experts Workshop in 2000 and Informal Policy Dialogue in 2001

Sponsored in Part by CIPE. Organization for Economic Co-Operation and Development (OECD, 1999, 2004).

- Oso, L., & Semiu, B. (2012). The Concept and Practice of Corporate Governance in Nigeria: The Need for Public Relations and Effective Corporate Communications. Journal Communications, 3, 1-16. https://doi.org/10.1080/0976691X.2012.11884790
- Parliamentary Joint Committee on Corporations and Financial Services (2006). Corporate Responsibility: Managing Risk and Creating Value. Canberra: Commonwealth of Australia. http://outageaph.aph.gov.au/
- Pedamon, C. (2002). Corporate Social Responsibility: A New Approach to Promoting Integrity and Responsibility. Company Lawyer, 31, 172-173.
- Post, J. E., Preston, L. E., & Sachs, S. (2002). Managing the Extended Enterprise: The New Stakeholder View. California Management Review, 45, 5-28. https://doi.org/10.2307/41166151
- Romano, R. (1998). Empowering Investors: A Market Approach to Securities Regulation. In K. J. Hopt et al (Eds.), Comparative Corporate Governance: The State of the Art and Emerging Research (pp. 143-217). New York: Oxford University Press. SEC Website with a Guide of All Corporate Governance Rules and Code in Nigeria. (2019). http://www.sec.gov.ng/rules-and-codes.html
- Shleifer, A., & Vishny, R. W. (1997). A Survey of Corporate Governance. Journal of Finance, 52, 737-783. https://doi.org/10.1111/j.1540-6261.1997.tb04820.x
- Smith, H. J. (2003). The Shareholders vs. Stakeholders Debate. MIT Sloan Management Review, 44, 85-90. Wieland, J. (2005). Corporate Governance, Value Management, and Standards: A European Perspective. Business & Society, 44, 74-93. https://doi.org/10.1177/0007650305274852
- Wogu, O. (2019). Corporate Governance: The Stakeholders Perspective. International Journal of Business and Management Review, 34, 423-433.
- Zollinger, P. (2009). Stakeholder Engagement and the Board: Integrating Best Governance Practices, Global Corporate Governance Forum. Focus, 8, 1-6