CORPORATE GOVERNANCE AN ORGANISATIONAL ATTRIBUTE OR AN ACADEMIC EXERCISE

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ABSTRACT

This conceptual paper provides an overview of the theory and application to the practice of corporate governance. The evolution of corporate governance theory and definitions are described, taking an international perspective. The paper offers insights at a national level into governance experiences within the UK, Ireland, and Cyprus.

The paper reviews four classic corporate governance theories most often cited in the literature. Each theory is critically discussed and applied at an organisational level. The authors introduce language theory, sociology, psychology and organisational theory as a means of

uncovering the changing governance epistemologies as corporate governance is more than economic and legal theories.

A summary table outlining key foci, actors, features and critique of each model is provided so as to enable the reader easily identify each in practice. The paper concludes with recommendations for future research.

Key terms: Corporate governance, board, behavioural theory, agency theory, stakeholder theory, resources dependency theory, stewardship theory, conceptual paper.

INTRODUCTION

One way of viewing the concept of corporate governance is to consider external and internal mechanisms (Brennan, 2010). Agency theory, otherwise known as managerial theory of the firm, (Jensen and Meckling, 1976) is an early model of corporate governance and can be viewed as either an external or internal instrument. Agency theory has attracted significant research attention over the past 40 years and today it is widely cited as an underpinning governance theory.

This paper discusses literature on the four 'classic' corporate governance theories and explores how these can be identified in practice by their underlying focus, actors, and other elements. Against the background of the theory, the paper outlines there are wider influences beyond the organisation that provide for a more holistic approach to governance.

Some questions addressed in this paper are: 1. what are the respective histories of corporate governance in terms of theory development? 2. What is the role of governance theory in influencing board practices and focus? 3. As governing does not take place in a vacuum what other factors should be considered?

The paper is structured as follows. Firstly, the historical influences on governance, its definitions and language are explored. The paper draws on four classic corporate governance theories; agency, stewardship, resource dependency and stakeholder theory as these are the most cited theories recounted in the literature. Each of these theories in turn emphasises different aspect of board governance. The researchers critique each governance theory or paradigm, summarising these in a table for ease of understanding. The paper concludes with recommendations for future research.

GOVERNANCE – ITS DEFINITIONS, HISTORICAL CHRONOLOGY, AND LANGUAGE

The writers suggest that an epistemological view incorporating the diversity of views from sociology, psychology, histography, economics and legal theory are essential to understand governance. Michel Foucault, cited in Cummings et al. (2016) proffers that the 'past is viewed in terms of making sense of the present …' (p.36). In a similar frame the authors suggest that viewing governance and its supporting activities through a Foucauldian lens enables an understanding of the concepts and frameworks that have evolved under the governance umbrella that are experienced today in practice. The aim is not to recount historical accuracy but review the storehouse of activity that has occurred, and to in turn, understand evolving trends. White (2010) states that historians deal in 'concrete reality' (p.192) as they seek to narrate their interpretation of an event and tell the story well. Alternatively, organisational sociologists define a form of life that portrays an interdependence in a complex society, e.g. market transactions in the business world (Ocasio, Mauskapf and Steele, 2016). Sociology reminds us that corporate governance is not only based on economic and legal theory (Kubicek, Stamfestova and Strouhal, 2016) but should be also interpreted through cultural and contextual lenses. Psychologists on the other hand explain governance mechanisms from the perspectives of the individuals involved, stressing the importance of human interaction in governance frameworks e.g. leadership behaviours and traits.

Corporate governance for the most part, may be considered as a contested, diverse and temporal concept, which historically has had many definitions (Cadbury 1992; Turnbull 1997; Organisation for Economic Cooperation and Development 2004; Mahadeo 2013; L'huillier 2014). Conventionally it was defined narrowly with the focus on the relationship of organisations and funders and the governance mechanisms for monitoring and control of the agent (Brennan, 2010). The debate continued in a search for an agreed definition, with researchers in healthcare, management, economics, accounting, and law being just some of the professional fields that have developed their own definitions. A useful consensus and broader definition of governance is put forward by the Organisation for Economic Cooperation and Development (2004) which defines corporate governance as involving 'a set of relationships between a company's management, its board, its shareholders and other stakeholders' (p.11). This definition portrays the organisation as an outward looking, complex social entity (Burr, 2003) and thus fits well in the context of the climate of globalisation. The definition also fits with the view of governance as having both an inward and outward focus and the navigation of a complex system.

In 1932 Berle and Means published "*The Modern Corporation and Private Property*" and, whilst they did not put a name to the discipline, their contribution influenced corporate governance systems in the United States. 44 years later the seminal paper of Jensen and Meckling (1976) had a similar economic related theme and was foremost in setting the foundations for agency theory and its relationship to the separation of the responsibilities and control of upper level management, board of directors and shareholders. The Jensen and

Meckling article has been cited more than 92,000 times demonstrating its contribution to the field. Whilst their article does not overtly mention corporate governance (Shah and Napier, 2017), corporate governance at the time was based on agency theory as distinct to a wider stakeholder approach. These seminal works began to set the narrative and dialogue around the concept of corporate governance.

Using Saussure's (1857-1913) approach to language and meaning demonstrates that variations in how words are defined can in itself leads to complexity, lack of clarity and misinterpretations. For example, 'oversight', 'control' or 'authority' are often used to explain 'governance'. Critics of Saussure posit that his theory on language and meaning was structured and 'frozen in time', rather than 'changing over time' (Leitch, 2010 p. 847). Post structuralist and postmodernist philosophers, e.g. Levi-Strauss, Derrida and Eagleton further criticised Saussure's theory as limiting because reviewing the language of governance without situating it within culture, context and time is only part of its understanding. In the idea that originated in Saussure, words can carry many meanings and the understanding of what words mean can change over time (Burr, 2003), who suggests that the meaning of words is constructed, and language depends on context and the interpretation given to it. This is very much the case with governance. Over the past 50 years, the language of compliance, conformance, control and performance has shaped the governance narrative. The 1970s meanings and understandings of terms such as 'oversight', 'control' or 'authority' and 'governance' seem somewhat out of context when compared to the 2020 interpretations.

Societal calls and in turn a contextual need for corporate governance arose out of failings in high-profile corporations in Europe in the 1980s and early 1990s including Barings Bank, Coloroll, Maxwell Group, Polly Peck, and Parmalet. In 2002 the combined impact of US financial reporting and other corporate scandals, e.g. Enron, Global Crossing, Tyco, WorldCom and Xerox, saw the Dow Jones Index plummet. The collapse of the Cyprus Stock Exchange, also in 2002 (Krambia-Kapardis and Psaros, 2006) was not of the magnitude of Enron or Worldcom. Weak corporate governance in the Cypriot banking sector saw a second collapse of the banks in 2013, resulting in a bailout by the Troika (Michaelides, 2014). In Ireland, the collapse of the Irish banking system and the 'Celtic Tiger' in 2008 also led to Ireland being 'bailed out' by the Troika (Bielenberg, 2018). In summary weaker public confidence and political concerns because of the market and organisational failures, on both sides of the Atlantic, were among the drivers for change and resulted in corporate governance initiatives being reinforced (L'Huillier, 2013).

The UK's response to its scandals was a focus on the development of external mechanisms. In 1991 the UK established the Committee on the Financial Aspects of Corporate Governance, led by Sir Adrian Cadbury (Johannesson et al. 2010). The Cadbury Report (1992) and a series of other reports such as the Turnbull Report (Turnbull, 1999) and Higgs Review (Higgs, 2003), which built on the original work of Cadbury, resulted in the non-statutory 2018 Combined Code (Financial Reporting Council, 2018) which is in operation today. In Cyprus, the Cyprus Stock Exchange introduced the Cypriot Corporate Governance Code in September 2002. The research of Krambia-Kapardis and Psaros (2006) found that few firms complied with "the provisions of the standards and the majority did not comply at any level" p. 229, thus the early adoption of a governance code for many Cypriot organisations was a mere paper exercise. Krambia-Kapardis and Psaros (2006) suggest that other initiatives were needed to improve compliance with corporate governance, including education highlighting its benefits. Ireland in 1991 was the earliest adopter in Europe of a governance code (Kubicek, Stamfestova and Strouhal, 2016) and today it embraces the principles of the UK Combined Code.

Discussion will now progress to recount the development of governance theory at national and organisational level.

THE DEVELOPMENT OF GOVERNANCE THEORY

Fundamentally, there are two international approaches to corporate governance applied at national level. The Anglo Saxon model that is a non-statutory, principles based approach followed in many countries, including UK, Cyprus and Ireland and the rules / legislative approach evident in the USA. These approaches can be aligned with a carrot and/or stick philosophy rewarding good and punishing bad behaviours. The principles approach follows a best practice 'comply or explain' model associated with governance codes following Cadbury (1992). The US chose the legislative route with the hurried passing by Congress of the Sarbanes-Oxley (SOX) Act in 2002. US companies are obliged under Federal Law to comply with SOX and non-compliance can result in a court appearance. The governance requirements of SOX appear to be grounded in positivist agency theory (Cohen et al. 2013).

The failings in the corporate world led to the external mechanisms for Corporate Governance described above. However, the internal mechanisms that evolved to support these at an organisational level must also be discussed. There are four key theoretical models that summarise practical application of governance at an organisational level. As outlined above, the earliest theoretical framework or model described is principal-agency theory, often simply referred to as agency theory (Jensen & Meckling, 1976; Chambers, 2012). With its origins in finance and economics (L'huillier, 2014) it is concerned with relationship and control, between the owner and their designate. Over time different theoretical governance models were proposed modifying this theory and removing the focus from the principal and agent (Freeman et al. 2016). Stewardship behaviour theory, originating in the disciplines of psychology and sociology, was next to come to prominence.

In contrast to the principal-agency model, stewardship theory advances an idea whereby directors (and CEOs) have fiduciary duties and can be trusted and hence they should be empowered (Turnbull, 1997). The third framework is the resource dependency model with its origins in sociology and can be defined as 'the linking role of the board to other organisations' (L'huillier, 2014, p.309). In this concept networking and what the director brings to the table is the interest. The fourth and final framework the authors identify is stakeholder theory. Boards that operate a stakeholder approach look for balance between different internal and external stakeholders needs (Huse, 2005; Chambers, 2012; Pettersen et al. 2012; Bismark and Studdert 2013; Millar et al. 2015).

APPLICATION OF GOVERNANCE MODELS TO PRACTICE

Having identified four models and their primary differences discussion now moves to exploring the **key focus, factors, actors and critique** of the four models. The authors will identify whether each model takes an internal or external focus; what are key distinguishing factors associated with each model; which of the governance actors plays the central role and the primary relationships stressed within the models; and finally offer a critique as to the shortcomings in each model. In doing so a picture of each of the four classic models evolves that will enable the reader to recognise which model is in operation, and to identify challenges and potential pitfalls they may experience or can expect. The models are now dealt with in chronological succession.

Agency Theory

Researchers are by no means united on a definition of agency theory. There is some degree of consensus on agency theory as a control and monitoring mechanism focusing inwards into the organisation. This is evident from the early research in legal, financial and management literature (Johnson et al. 1996). The pessimistic beliefs of agency theory assume the self-serving opportunism of management (Roberts, McNulty and Stiles, 2005). However, this is critiqued as showing a simplistic view of human nature. Boston et al. (1996) propose that principal-agency theory is useful for analysing public policy issues, but it would not be suitable for analysing complex social interactions. Pettersen et al. (2012) report that its monitoring and compliance focus leads to lower performance of a board following the agency model, e.g. board moving from strategic discussions to focusing on budget monitoring. In essence the critics suggest such boards are focused on the compliance of the now rather the strategy of tomorrow. A limitation of agency theory is that it has an inward focus of economic efficiency and does not consider those outside of the organisation who may be affected by organisation decisions (Brennan, 2010). Agency theory highlights the only relationship of interest is between the board and management (DeRegge and Eeckloo, 2020). The absence of trust, and information asymmetry are core tenets in agency theory, the board do not trust management (Brennan 2010) and the shareholders do not trust the board, each needing to be monitored and controlled.

Organisations exhibiting traditional agency style board behaviour can be identified in practice whereby staff are being held accountable, burdened under internal reporting requirements to ensure compliance, and exhibit perceptions of the CEO being sandwiched, both upwards and downwards, in the accountability chain (Bismark and Studdert, 2013; Endacott et al. 2013; Freeman et al. 2016; Jones et al. 2018). Under agency theory it is assumed that managers (agents) may not act in a way to maximise shareholder (principal) value and hence managers should be controlled by the board and have little discretionary power (L’huillier, 2014). Some authors suggest that agency theory can be identified in the public sector reforms in the UK of 20 years ago and the introduction of managerialism, bureaucracy and loss of autonomy.

Stewardship Theory

Stewardship theory is an early challenger of the agency theory perspective (vanEes, Gabrielsson and Huse, 2009) and the agency theory view of the relationships between management and the board. Whilst agency theory is dominated by the economics and finance disciplines, stewardship theory is dominated by the disciplines of social psychology, organisational theory, and psychology. Here, the CEO / General Manager is identified as a key internal actor on the governance stage and whereas agency theory assumes information asymmetry, the stewardship model assumes the CEO is trustworthy (vanEes, Gabrielsson and Huse, 2009). Later studies discuss governance behaviours related to stewardship theory as boards attempting to implement a model of shared values built on high trust (Millar et al. 2015; Veronesi et al. 2015; Freeman et al. 2016; Pronovost et al. 2018).

This concept of shared values includes the importance of balanced monitoring and reporting of both *hard information* (in the form of financial reports, KPI dashboards and scorecards and national benchmarks) and *soft intelligence* (in the form of board walkarounds, staff stories and experiences), (Jiang et al. 2009; Jha and Epstein, 2010; Freeman et al. 2016; Mannion et al. 2017). Implied trust of the CEO is associated with early stewardship theory whilst later evolutions of this theory identified CEO behaviours that recognise the importance of a rounded approach to knowledge generation via the provision of hard and soft information on which trust and confidence is fostered.

Organisations exhibiting stewardship style board behaviour can be identified in practice whereby a collaborative approach between management and boards who delegate authority and responsibilities to the CEO is evidenced. The board assumes that motives of management are aligned with the objectives of the board and shareholders (Brennan, 2010). Focus on compliance is reduced, resulting from the fostering of trust. The CEO role under stewardship theory has visibly evolved to become a conduit between the board, shareholder, and employee. The CEO is the voice of the organisation with a strong visible presence. Under this theory the CEO is seen as a steward, a team player, and not as an agent or opportunist.

These first two theories have approached corporate governance via the relationship between management and the board, with agency theory seeking to control management's self-interest while stewardship theory considers management and board motives to be aligned (DeRegge and Eeckloo, 2020). Whilst both these are theories of inward facing governance, the next two theories shift the focus outwards and take a broader perspective of corporate governance (Huse, 2005).

Resource Dependency Theory

Empirical data suggests boards have a wider role than espoused by agency theory (Roberts, McNulty and Stiles 2005) and stewardship theory, suggesting that board members can also give advice, open doors to new relationships and enhance strategy. Resource dependency theory emphases external relationships as these can used to leverage advantage (DeRegge and Eeckloo, 2020). The premise of resource dependency theory is that organisations seek to make links and connections for the achievement of the organisation goals (vanEes, Gabrielsson and Huse, 2009). In industries that have been studied and espouse to resource dependency there is evidence of board members who bring *human capital*, in the form of specialist expertise, experience and knowledge and *relational capital*, in networking and external stakeholder associations into the boardroom. There is solid evidence in the literature of boards exhibiting these competencies and behaviours and demonstrating high performance activity in governing with both an inward and external focus on the achievement of goals (Jiang et al. 2009; Jha and

Epstein, 2010; Freeman et al. 2016; Mannion et al. 2017). Having these skillsets at the board table is key for managing internal and external relationships and for acquiring resource and strategic advantage.

However, other researchers of this governance behaviour demonstrate conflicting views. As a caveat Hicks Midanek (2018) cautions that it is important to establish the appropriate tone at the top and 'Explicitly include screening for people's character as well as competence' as 'corporate reputations can be destroyed in an instant' (p. 176). L'huillier (2014) argues, based on the theory of Hung (1978) and the earlier findings of Mace (1971), that resource dependency behaviour theory should be viewed from a critical perspective and cautions that the human resources could demonstrate power via their 'old boys network and school tie brigade' (p. 310). L'huillier's (2014) critique was based on a governance study that is almost 50 years old. It does nevertheless provide a critical and balancing perspective which is quite different to the discussion on behaviours described earlier in the paragraph.

Organisations exhibiting resource dependency style board behaviour can be identified in practice by their strategic co-option of board members from influential networks, banking, politics and similar domains. Boards characterising resource dependency seek to bolster board strength by including the right participants in the boardroom (Stock, 2018). This may be achieved through formal connections, especially with financial institutions on the theory that such connections may facilitate access to cashflow for the organisation (Johnston et al. 1996).

Stakeholder Theory

The final concept is stakeholder theory which traces its origins to management theory, politics and law (L'huillier, 2014). Again, there is no consensus on the definition of stakeholder theory and it is loosely defined in the literature. Researchers generally agree that it is about a balancing act with boards taking a pluralist approach where stakeholders interests are considered alongside the interests of funders and employees. Stakeholder theory takes a broader perspective on corporate governance as it focusses on the interests of each stakeholder in the governance process. DeRegge and Eeckloo (2020); Huse (2005) argue for this inclusiveness and recognise that stakeholders may be internal or external actors. Pettersen et al. (2012) and Malfait et al. (2017) stress boards need to secure the interests of stakeholders and looked at involving stakeholders in decision making processes. The research of Mannion et al. (2017) acknowledges that organisations have overlapping stakeholder interests, both co-operative and competitive, and suggest these overlapping interests can be addressed in an integrated and balanced fashion.

Freeman et al. (2018) considers the tensions in stakeholder theory and asks the question 'Is stakeholder theory primarily aimed at creating value for all involved or at creating value for the firm?' (p. 210). This question led Freeman et al. (2018) to ponder who is all. The article discussed ethics and how much of ethics is concerned with political theory. As seen above in the resource dependency model, many board appointments may be construed as having political undertones. Huse (2005) cautions of a dominant coalition of stakeholders in the board room and the challenges this may bring.

Organisations exhibiting stakeholder style board governance behaviour can be identified in practice by their broad representation in the boardroom, including the appointment of employees as directors. In Ireland, the composition of board membership in recent years demonstrates an increase in the use of this model in areas such as professional regulation and statutory and not for profit boards. Indeed, internationally issues such gender balance, ethnic minority representation, diversity and inclusion are all very much to the fore. These trends in behaviour are indicators of stakeholder theory.

The latter two theories discussed above, resource dependency theory and stakeholder theory, have as their focus the linking of the organisations with the external environment in which the organisation is situated. These theories do not place as much a focus on the individual (e.g. agent or steward) as is the case with the first two theories. Agency theory is still the dominant governance theory and it is the starting point for building an understanding of governance (L'Huillier, 2014).

VISUALISING GOVERNANCE IN PRACTICE

Drawing on the theory and examples of practice in the earlier sections of the article, Table 1 below represents the key ideas in each of the four classic models and has been developed as an easy to use tool to aid understanding, identification and classification of governance concepts observed in practice.

	Agency	Stewardship	Resource Dependency	Stakeholder
Popularised in	1970's	1980's	1980's	2000's
Key focus of theory	Inward	Inward	Inwards and Outward	Outward
Key actors in the governance model (**Bold** emphasis demonstrating key actor)	**Owner** **Board** Manager	Owner **Board** **Manager**	Owner **Board** Manager	**Stakeholders** Owner Board Manager
Key distinguishing factors,	Theoretical origin in economics and finance Assumes conflict of interest between owner and agent.	Theoretical origin in social psychology, sociology and organisational theory Empowerment of CEO	Theoretical origin in sociology Boundary spanning Board as gatekeepers	Origins in management, political and legal theories Behavioural viewpoint Co-operating, consulting and

	Agency	Stewardship	Resource Dependency	Stakeholder
	Asymmetry of information Command and control of the actions of agent Oversight	Implied trust evolving to explicit trust	Social networks Tone at the top Leveraging external relationship	involving beyond the boardroom, inside and outside the organisation Voice of the customer, diversity and inclusion in the boardroom
Key critique of the governance model	Explicit lack of trust Financial focus to the determent of other views Short-term perspectives	Assumption of trustworthiness may leave organisation open to fraud	Old Boys club may lead to exclusion of persons or groups outside 'the club' Misuse of individual or collective power	Political appointments could disturb board business Some stakeholders may be marginalised as their interests may be omitted

TABLE 1. GOVERNANCE THEORIES SUMMARY AND RECOGNISING THEORIES IN PRACTICE

To effectively understand corporate governance, it is important to recognise that contextual issues have shaped its development to date. As demonstrated by the summary points of Table 1, the internal control focus of the 1970s and 1980s made the agency model a suitable approach for the time, especially following the scandals in Europe and overseas. In the multicultural diverse society at the turn of the 21st century a new model for governance was shaped to be reflective of increased calls for participative governance. In making sense of current governance practice, the authors highlight the contribution of governance models of the past including their inherent shortfalls and how these have evolved and enabled an understanding of the current pluralist perspective. The reader is again reminded of the words of Foucault that the 'past is viewed in terms of making sense of the present …' (Cummings et al. 2016, p.36).

As the world wrestles with the COVID-19 pandemic, it is prudent to reflect on past and current models as these are likely to evolve once more. Indeed, the authors argue that the COVID-19 pandemic is once more changing the governance routines for many organisations. Boards must now serve more than the shareholders and investors in this time of complexity and change. They are required to truly take a pluralist approach and consider the advice of non-traditional boardroom actors such as public health specialists, scientists, social media influencers and a raft of others. While at the same time continuing to engage with the traditional actors such as the banks, funders, staff and customers and clients. As the concept of the stakeholder is again at a crossroads and being redefined by COVID-19, the language of governance will likely evolve in the coming decade in response to the multiplicity of factors. Roberts, McNulty and Stiles, (2005) also argue for the progress of the corporate governance agenda. Perhaps a hybrid of all four models will be the future of corporate governance.

CONCLUSION

In this paper a chronological / historical perspective of how governance theory has evolved over the last 50 years has identified that different governance theories are not 'a string of isolated pearls but a mosaic in which each work fits into a larger frame' (Leitch 2010, pg. xxxiv). The theoretical foundations of the language and meaning of governance has been examined, identifying the different lens through which the theory is espoused. It became evident how the language of governance and the influence of corporate governance on board practices has changed from a 'control' 'information asymmetry' and 'agency' approach in the earliest theory to 'collaboration', 'pluralism' and 'voice of the customer' approach in stakeholder theory.

The concept of pluralism in a wider sense is proposed, suggesting that rather than one dominant theory, a hybrid of all four theories is critical to progress the corporate governance agenda. Like others, the authors argue not for an either-or approach to one theory being more valid than another but rather linking governance models to develop a multi theoretical approach. How external and internal mechanisms are enacted in practice by organisations have been reinterpreted over the decades. Corporate governance, whilst having its foundations in academic exercises, is indeed an organisational attribute that has shown itself worthy of its place within the language, culture and context.

RECOMMENDATIONS FOR FUTURE RESEARCH

The corporate governance discussion set out above may inspire researchers to undertake further research in this area. Some recommendations for consideration are as follows:

Understanding the historical changes in governance is important as it sets the scene for 21st century governance. Given the dearth of published research on governance mechanisms in Cyprus, now is the time to shift the scholarly governance debate from the UK, USA, Australia and Canada. Researchers should conduct research in Cypriot organisations to determine the operational governance model and explore the relationship to organisational performance.

Much research in the area of corporate governance is focussed on quantitative research of the formal structures and mechanisms of boards, however there is also the informal, softer side of corporate governance which is often ignored in academic writing. This softer side of governance relates to the process and practices of governing and has been referred by Huse (2005) as the 'opening of the black box' on board behaviour. Whilst there are some studies which use qualitative research techniques further work is needed in this area to enlighten the picture of corporate governance.

In response to COVID and other unexpected PESTLE factors boards need to be adaptive and creative in their approach to change. To do this boards need directors and leaders with a different skillset. This is an area of governance that warrants empirical investigation. Future studies could explore the implications of how boards have responded to the pandemic and if the response succeeded or failed. This research could be written up in the form of case studies.

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