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WHICH CORPORATE GOVERNANCE? THIS IS MY BUSINESS

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Abstract

With increasing corporate declines witnessed in the recent past, corporate governance is commonly sought as a panacea to corporate problems. Corporate governance has traditionally been viewed through the lenses of the agency theory with the firm being seen as a nexus of contracts and the main thrust being to investigate and delineate optimal shareholders and managers' contracts. This view has largely been criticized for lack of a holistic view of corporate governance. Corporate governance involves a configuration of interdependent elements and therefore involves systems and practices that are embedded in institutional and legal frameworks. Corporate governance practices and systems, in line with institutional theory, are institutionally determined and directed and therefore effective corporate governance practices are contingent upon institutional environments in which the organizations and their stakeholders are rooted in. More specifically, organizations and their stakeholders' behaviours are founded on systems of norms and relationships that are culturally and socio-politically constructed. The effect of these norms and relationships may be more influential in the context of family firms. Families are considered the primary source of identity and provide interrelationships and social arrangements that allow people to pursue social life. Family systems and connections form core values and fundamental principles which underlie the family firm. Consequently, family core values influence the behaviour in the family enterprise. Additionally, family managers are associated with stewardship attitudes, altruism, shared values and attitudes and lower agency costs. However, this comes at the expense of weaker governance structures and neglect of other firm stakeholders. In line with this, it is imperative to explore the role of ownership and control in the development of corporate governance systems of family firms to comprehensively understand corporate governance in family firms.

Key words: Corporate governance, governance mechanisms, governance structures, institutional theory, agency theory, stakeholder theory, family firms, ownership, owner-control.

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Background

Corporate governance involves the mechanisms by which a firm is governed so that it can be run efficiently and effectively. Shleifer and Vishny (1997) argue that corporate governance can be viewed as the mechanisms to control the managers of a firm to ensure they do not compromise the ability of the owners to derive a return on their investments. This is in a bid to align the interests of the business financiers and managers so that the financiers have a measure of certainty against the risk of funding the business and also to avoid managerial opportunistic behaviour.

Arslan and Alqatan (2020) observed that corporate governance is a division of governance that relates to governance within an organizational structure which over time has emerged as a field of study. The scope of corporate governance transverses multiple disciplines including management, politics, economics, finance, ethics, law and others. This may have contributed to the diversity in the definition and understanding of the concept.

The Shareholders Perspective

Traditionally discussion on corporate governance was founded on the problems that arise between ownership and management. This perspective emanated from the seminal work of Berle and Means (1932) on corporate ownership structures which basically argued that the separation of ownership and management created problems due to their divergent interests. This view gained foothold with the coalescing of the agency theory by Jensen and Meckling (1976). Agency theory views the firm as a nexus of contracts between owners as principal and managers as agents. Specifically, owners and managers have divergent risk preferences leading to managerial decisions and actions that are contrary to owners' preferences. To align managerial and owners' preferences, internal monitoring mechanisms have to be enacted which provides the backdrop for corporate governance.

Corporate governance through the shareholders' perspective gives shareholders primacy in corporate governance discussions. This view advocates for mechanisms that align the interests of managers with their shareholders (Adegbite & Nakajima, 2012). Corporate governance focuses on mechanisms that can reduce the egocentric and opportunistic managerial tendencies such as board of directors, executive compensation contracts, concentrated ownership and financial reporting. The underlying assumption with this view being that by managing the shareholders-managers' problems, the firm will operate in a more efficient manner and deliver better performance. Consequently, this view seeks to direct managerial behaviour in a manner consistent with shareholders' interests.

The shareholder view of corporate governance has been the subject of study by many scholars (Dalton, Hitt, Certo, & Dalton, 2007) with inconsistent findings (Filatotchev & Boyd, 2009). Indeed, the premise of a divergence between owners and managers' interests has been under scrutiny (Ghoshal, 2005) with scholars questioning the extent of this divergence. Connelly, Hosskisson, Tihanyi and Certo (2010) observed that exploring corporate governance through the agency theory lenses only offered an over-simplified view of the nature of relationships between shareholders and managers. Judge (2009) further noted that this view is overly narrow since it neglects other stakeholders who may have different interests. These criticisms levelled at the shareholders' perspective have paved way for the arguably more encompassing stakeholders view of corporate governance.

The Stakeholders Perspective

This view involves a broader perspective of the firm by considering legitimate interests of organizational stakeholders with an aim of delivering value to all the stakeholders. In line with this corporate governance is seen to be a structure of rights and responsibilities among parties with an interest in the firm (Aoki, 2001). Corporate governance mechanisms here are enacted to ensure that executives heed to the interests and rights of the organization's stakeholders. Consequently, corporate governance mechanisms go beyond monitoring and controlling managerial discretion to other imperatives such as innovation and social responsibility. On the overall, corporate governance here aims at allocating resources in a manner that satisfies all stakeholders.

The stakeholder view of corporate governance is anchored on the normative stakeholder theory which holds that an organization has responsibility to a wider group of stakeholders. The theory as advanced by Freeman (1984) views the status of stakeholders as moral agents and focuses on the effect of corporate activity on all stakeholders of the firm. It proposes that firms should adopt stakeholder oriented answers to corporate governance questions (Hendry, 2001). Ultimately, the stakeholder theory advocates for a broader view of business actors who shape the corporate governance agenda rather than the shareholder orientation of the traditional corporate governance approach. Despite lifting the restrictive assumptions of the shareholders' view, stakeholders' theory does not link the corporate governance discussion to the broader context of the organization's environment. This has paved way for the entry of organizational contexts into the corporate governance discussion. Filatotchev and Boyd (2009) observed that research in corporate governance should seek to uncover the diversity of arrangements and how their effectiveness is affected by their alignment with situational variables in diverse environments.

Institutions and Corporate Governance

A key weakness associated with the shareholder and stakeholder perspectives is the restricted role of institutions in corporate governance. Creed, DeJordy and Lok (2010) argued that corporate governance is formed by institutional factors. Factors like social values, politics, culture, organizational activities and context have been linked to corporate governance (Arslan & Alqatan, 2020). Aguilera, Gospel, Jackson and Filatotchev (2008) observed that the effectiveness of corporate governance mechanisms is contingent on the organizational context. Fiss (2008) noted that corporate governance systems are embedded in larger institutional and legal frameworks and to their effectiveness largely depended on the institutional environment. Young, Peng, Ahlstrom, Bruton and Jiang (2008) argued that due to the different institutional environments, effective corporate governance in developed economies were likely to be ineffective in emerging economies. Indeed, many corporate governance practices have been adopted from the developed nations and have largely assumed publicly traded organizations with distributed shareholding. However, it is imperative to scrutinize corporate governance practices in the light of institutional environments.

An institutional approach to corporate governance requires the recognition of the idiosyncrasies that arise among different organizations. To begin with, corporate governance involves power relations with issues of power and control taking a pivotal place. Corporate governance mechanisms define how social relations should be constructed and the interests that take priority (Fiss, 2008). More specifically, the behaviour of individuals in an organization is contingent on the power relations among them. This implies that when corporate governance mechanisms are enacted in an organization, compliance with them or resistance to them is pegged on the power arrangements among the organizational constituents. In essence, whether the governance practices are adhered to in an organization or not is largely determined by who has more power regarding the implementation and adherence to the practice.

Corporate governance from an institutional perspective also involves political processes. Davis and Thompson (1994) and Fiss (2008) posit that political processes and not property rights as advocated for by the agency theory determine corporate governance practices. Consequently, corporate governance models revolve around the distribution of power and natural order of interests implying that they attempt to rationalize proper allocation of power and resources. In this case therefore corporate governance models are derived from the cultural belief and rule systems that guide decision making and are likened to control mechanisms which help organization actors interpret their actions and those of others. The presence of political processes in corporate governance raises the question of acceptance and resistance to corporate governance imperatives. Depending on the institutional environment some practices might not take root in an organization or will only be enacted following a protracted bargaining and negotiation process.

Corporate governance models also differ among organizations due to the different interpretations attached to them making their meanings unstable. When governance models are applied across institutional contexts they tend to acquire different meanings or become ineffective (Adegbite & Nakajima, 2012; Fiss, 2008). Every organization operates within an institutional context which is shaped culturally through acquired rules and assumptions through which corporate governance practices are filtered through for their enactment and application. Specifically, Adegbite and Nakajima (2012) and Arslan and Alqatan (2020) argued that corporate governance practices that are effective in developed economies may fail to yield benefits in emerging economies with different social cultural context shaping the institutions.

For effectiveness, corporate governance models have to be learned and passed on to organizational members. This involves reproduction, socialization and conversion of new members. This process of transmission is riddled with institutional influences. This may result in erosion of the accepted beliefs and assumptions over time associated with the corporate governance models (Dore, 2000). On the other hand, organizational members are likely to transmit only those practices that are aligned to their personal values and interests. Such values are heavily influenced by the institutional environment and so by filtering the governance practices that take root in the organization end up reflecting institutional alignment.

Institutional Theory

Institutional theory places institutions at the centre of the organization design and conduct whereby organizations are a reflection of wider institutions (Berthod, 2016). The theory argues that the behaviour of firms is governed by its institutional environment which consists of the organization's social context, scope of its activities and social relationships (Doshi & Khokle, 2012). Institutions will therefore encompass beliefs, rules, norms and values that are taken for granted which end up shaping organization behaviour. The institutional environment is what bestows legitimacy and identity and minimizes uncertainty for the organizations.

Institutional theory argues that the organization does not operate in a vacuum but rather is influenced by both internal and external influences. Berthod (2016) noted that traditionally, institutional theory focused on internal influences such as power, politics and change but latter treatments sought to explain the homogeneity among organization designs and practices. Contemporary institutional theory reconciles both internal and external influences and argues that organizations operate within a multitude of external and internal factors which shape organizational effectiveness. DiMaggio and Powell (2000) argued that institutions lead to uniformity in business practices through coercive, mimetic and normative mechanisms. Coercive mechanisms pressure the business to conform to societal expectations. Mimetic practices involve pressure by peers to conform to certain behaviours while normative practices involve internalization of believes about what behaviours are suitable. These mechanisms result in organization behaviour that is aligned to societal norms.

Institutions denote beliefs, roles, rules and symbolic elements that can affect the organization independent of resource and technical requirements which can be regulative, normative or cognitive (Scott, 2013). Institutions give the organization legitimacy especially when driven by normative (enforced by what is appropriate) or cognitive (taken for granted mental models of how work should be done) elements. Berthod (2016) argued institutions underpinned why organization adopted legitimate features and practices even without regard for their relevance and that institutions were driven more by the taken for granted nature of institutions than utilitarian arguments. He further observed that when practices were widely accepted without recourse to analysis or relevance then such practices were institutionalized.

Institutional theory refers to long lasting systems of social beliefs and socially organized practices that are associated with several functional areas of societal systems therefore provides an understanding of corporate governance systems by understanding the institutional environments that support or hinder their legitimacy (Adegbite & Nakajima, 2012). It provides a mechanism of understanding how strategies, processes, competences, outlooks and distinctive forms emerge from organizational interaction and adaptation to internal and external environments (Filatotchev & Nakajima, 2010). This thus guides understanding of how corporate governance mechanisms are enacted and implemented within organizations and more specifically what drives corporate governance mechanisms in different institutional contexts.

Family Firms

Family firms constitute firms in which family members can appoint the board of directors either directly or through financial holdings (Minichilli, Corbetta & MacMillan, 2010). Mwangi, Awino, Ogollah and Ogutu (2016) summarized family involvement into three mechanisms namely ownership, control and management. Involvement through ownership happens when a family is the dominant shareholder. This provides control but in some cases control is achieved through voting rights that arise from voting structures such as cross-holdings, pyramids, multiple share classes and voting agreements. Family involvement can also be through board representation or management representation (Pouziouris, Savva & Hadjielias, 2015).

Subramanian (2018) asserts that when families are involved in businesses, ownership and management are the same or the owners exert very high control over the strategic decisions of the firm. In this case, the fundamental assumption of agency theory i.e. the separation between management and ownership collapses. Consequently, family firms have been evaluated more from the stewardship theory rather than the agency theory. Stewardship theory according to Davis, Schoorman and Donaldson (1997) assumes a steward who derives more utility from collective behaviour than self-serving behaviour. The steward is more driven towards organizational interests and good management of corporate resources and exhibits shared values and altruistic behaviour. In this case therefore there is alignment between the principal’s and the agent’s interests.

Consistent with the stewardship theory, it is expected that family firms would exhibit very high standards of corporate governance due to the convergence of ownership and management interests. However, family firms have serious corporate governance problems (Subramanian, 2018) and tend to have weak corporate governance structures in practice. In Kenya, several family firms have faced problems which have been, at least in part, attributed to corporate governance lapses. These include Nakumatt Holdings Ltd, Tusker Mattresses Ltd, Oriental Commercial Bank Ltd, Marshall’s East Africa Ltd, Imperial Bank Ltd, Chase Bank Kenya Ltd and Oserian Flowers Ltd (Wairange, 2018; Mahadeo, Soobaroyen & Hanuman, 2012). Given that these firms are derived from industries where other firms are able to enact and implement relatively strong corporate governance practices such as the banking industry, the lapses in these firms warrant scrutiny. Addae-Boateng, Xiao and Brew (2014) posit that family firms differ with non-family firms in terms of their models of corporate governance which require attention to both the family and non-family interests.

In line with the institutional theory, corporate governance practices are institutionally determined and directed (Fiss, 2008). While the institutional environment in family firms is influenced by external factors that are largely similar with other firms in the industry, the internal elements present a unique setting for these firms. Specifically, Arslan and Alqatan, (2020) observe that families give their firms identities and their systems and connections are the basis of the core values and fundamental principles which underlie the firm. These core values then influence the behaviour of the members of the family firm. This study proposes that the family ownership and control undermines corporate governance practices. The convergence between ownership and management may create an environment where accountability is little and there is a casual approach to corporate governance which leads to failures in enactment and implementation of strong governance practices.

Managing family firms puts additional pressures on the directors since they have to balance family interests in addition to the usual business pressures in non-family firms. Iqbal, Pendergast and Herrera (2020) observed that directors in family firms must grapple with situations where stakeholders have conflicting agendas usually with equal power resulting in uncomfortable conversations on issues like succession, compensation and management performance. These can be exacerbated by non performing family members especially in the upper levels which can then lead to governance practices such as accounting and auditing to be overlooked. Additionally, conflicting interests in the organization can confound executives as to the governance practices that are appropriate within the firm. It is also common to find that most decisions are arrived at during personal family time like vacations and dinners where non-family managers and directors may not be present to weigh in on the decisions made. This leads to a breakdown of governance mechanisms.

Bertrand and Schoar (2006) in their investigation of family firms argued that political connections provide huge benefits for private firms especially in high corruption economies with preferential access to public resources. They observed that family firms with strong trust relations had an easier time building and maintaining political connections or sometimes fronting family members for political positions. Due to this, powerful family businesses were inherently linked with exchanging favours with politicians and by extension corruption. This link is a direct violation of corporate governance and tends to propagate underperforming family firms in an economy.

Family roles also have an important place in family firms. It is common to find the positions in the management of the family firm being pegged on the role played by the family members in the family unit. For instance, the Chief Executive Officer (CEO) tends to be the patriarch of the family and order of birth also determining seniority in the firm. The strategic direction of the family firm is also largely driven by family positions and seniority. Bertrand and Schoar (2006) found out that younger generations tended to maintain overall strategy even when market forces demanded otherwise due to a sense of duty and respect to their elders. This they noted complicated the dynamics between family values and formal institutions thus raising the governance costs for family firms. They concluded that while family ties and values yield comparative benefits in family firms but inability to change them in the long term may be more detrimental in the light of organizations with more advanced formal institutions.

Conclusion

The family influence in family firms cannot be overemphasized in understanding corporate governance within them. Consistent with the institutional theory, the practices that are adopted, emphasized and enacted in family firms are intertwined with family values and family influences in the firm. Consequently, governance practices that are not esteemed by the family may never take root in the family firm. This is especially in firms where the owners are involved in management or have significant control over the decision making process.

From the stewardship theory propositions, corporate governance mechanisms may appear unwarranted in family firms since the owners are expected to adopt stewardship behaviours. Subsequently family involvement may arguably be seen to act as a governance mechanism in itself and enacting other governance mechanisms may be perceived as wastage of resources or worse still as a signal of mistrust and acrimony among family members involved in the management of the firm. However, given the increasingly complex business landscape, family values may not guarantee continued success. In other, words the stewardship benefits envisaged in the stewardship theory may not hold in the light of firms with thorough governance mechanisms and in such cases family values are not strong enough to ward off an increasingly complex environment.

This paper, therefore argues that the family institution constitutes a big part of the family firm and that family values, norms and practices greatly shape the governance environment in the family firm. For that reason, any discussion on corporate governance in family firms must take cognisance of the family influence in the governance mechanisms enacted by the firm. This requires understanding of the multiplicity of stakeholders within a family firm which is compounded by the division between family and nonfamily members which in many cases hinders the success of traditional governance mechanisms in family firms. This largely explains the lapse of governance in many family firms. From a theoretical perspective, corporate governance in family firms is only comprehensively underpinned by the stakeholder and institutional theories which involves recognizing that the family in a family firm is a powerful enough stakeholder to shape the environment in the firm. Corporate governance mechanisms in the family firm will therefore be reflective of family interests, sometimes to the detriment of the family firm.

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