

DETERMINANT FACTORS FOR SUCCESS OF CORPORATE GOVERNANCE IN AN ORGANIZATION

Arinze Ngwube

*Federal University Oye-Ekiti
Ekiti State Nigeria*

Abstract

The discourse on corporate governance can become conceptual and scientific beyond the reach of the ordinary investor and the larger society. It is vital that the language of corporate governance be understood by the ordinary investor who may not have a finance degree. There is the need for corporate governance to move from mount Olympus of the boardroom to the valley of the ordinary investor. This will ensure a stronger shareholder voice and better governance of our institutions. In this paper we will examine the factors that determine the success of the quality of corporate governance of an organization.

Introduction

The right way to frame our world has become irresistible in the twenty first century with corporate scandals and failures on the rise. You find a situation where auditors conniving with CEOs to 'cook-the book' to spin market share and prizes; The emergence of portfolio CEOs and senior board members settling themselves with fat-cheques, pensions and severance package at the expense of shareholders and investors. What is the essence of proper governance in place for the business enterprise? Some people feel there is no need for it. Some human beings have taken the issue of governance with levity. There are examples of catastrophic consequences where governance had failed such as Enron, Challenger Space shuttle, Maxwell Empire (the media mogul) BCCL, distressed banks and bankrupt public enterprises in Nigeria.

Recently there has been a lot of media attention placed on the subject of corporate governance following in the intervention of Central Bank of Nigeria (CBN) in the banking sector that led to the removal of the Chief Executive Officers (CEOs) of five banks in Nigeria. The apex bank identified poor corporate governance as one of the major factors that contributed to the predicament of the affected banks. Corporate Governance is becoming fashionable today because of the increasing realization that the application of high standards of corporate governance in general improves the performance of companies and its ability to attract the much needed investment capital.

Definition of Corporate Governance

The meaning of corporate governance both from a dictionary definition as well as definitions by various authors are reviewed here. The Oxford English dictionary defines corporate governance as the system by which companies are directed and controlled. It deals largely with the

relationship between the constituent parts of a company-the directors, the board (and its sub-committees) and the shareholders. Other writers like Cochran and Warwick (1988) define Corporate governance as “an umbrella term that includes specific issues arising from interactions among senior management,shareholders,board of directors and other corporate stakeholders”. John Pound in his article “The promise of the Governed Corporation” states that “at its core, corporate governance is not about power but about ensuring that decisions are made effectively “.It is about reconnecting two critical parts of the corporate governance equation-shareholders and board members-to the decision –making process. In another publication, Corporate Governance in Africa, corporate governance is defined as “the set of mechanisms through which outside investors are protected from expropriation by insiders (including management ,family interests and/or governments).Gregory Pritchard defines corporate governance is all about ensuring effectiveness and efficiency of operations; reliability of financial reporting; compliance with laws and regulations; and safeguarding of assets. Corporate governance refers to the private and public institutions, including laws, regulations and accepted business practices, which in market economy, govern the relationship between corporate managers and entrepreneurs (“corporate insiders) on one hand, and those who invest resources in corporations, on the other (Oman,2001).The essence of corporate governance arises because of the separation of management and ownership in the modern corporation. In practice, the interest of those who have useful control over a firm can differ from the interests of those who supply the firm with external funding. The ‘principal-agent’ problem is reflected in management pursuing activities which are detrimental to the interest of shareholders of the firm .The agency problem can usually only be mitigated through the protections derived from corporate governance.

It ensures that large corporation are well run institutions that earn the confidence of investors and lenders. The process ensures safeguards against corruption and mismanagement while promoting fundamental value of a market economy in a democratic society (CIPE 2002).The value of governance is of total importance to shareholders as it provides them with a level of assurance that the business of the company is being conducted in a manner that adds shareholder value and safeguards its assets. This means that there is less uncertainty associated with investment-a situation that encourages bankers and lenders to be favourably disposed to the company. Furthermore the higher the risk, the higher the expected rate of return. If a company adopts and implements good corporate governance practices, shareholders are retained and new investors attracted. Institutional investors will indicate willingness to pay premium for shares of a well governed company. Hence good corporate governance is necessary in order to :1) Attract investors both local and foreign and assuring them that their investments will be secure and efficiently managed ,and in a transparent and accountable process 2) Create competitive and efficient companies and business enterprises 3) Enhance the accountability and performance of those entrusted to manage corporations 4) promote efficient and effective use of limited resources

Musa al-Faki reviews Good corporate governance as the rules and practices that govern the relationship between managers and shareholders of companies as well as how other stakeholders contribute not only to the growth and financial stability of corporate enterprises, but also promote financial market integrity and economic efficiency. Smerdon(2006) in his book, A practical Guide to Corporate Governance accepted this definition because it has stood the test of time and has been widely adopted in different jurisdictions. Professor Andrew Chambers in a

book titled Corporate Governance handbook criticized this definition as focusing too much on the control side of things than on the formulation of policy and the development of strategy. John Colley and others in their book "What is Corporate Governance?" summarized the working of the system thus: "The owners (shareholders) elect directors as their representatives to manage the affairs of the business. The directors, who are referred to as board of directors then delegate responsibility for actual operations to the chief executive, whom they hire. The CEO is accountable to the board of directors, which collectively and individually, is accountable to the shareholders. In addition to its role in selecting the CEO, the board also advises on and consents to the selection of the business and strategies of the firm as well as oversees results. In sum, this system of authoritative direction, or government, is known as Corporate Governance".

Ira Millstein (2003) defined Corporate Governance as "that blend of laws, regulation and appropriate voluntary private sector practices which enable the corporation to attract financial and human capital, perform efficiently and thereby perpetuate itself by generating long term economic value for its shareholders while respecting the interests of the stakeholders and society as a whole". The Organization for Economic Cooperation and Development(2009) define corporate governance as a set of relationships between a company's management, its board, its shareholders and other stakeholders such as the company's,employees's suppliers,customers,regulators,creditors,the working environment and the wider community. It defines the distribution of rights and responsibilities among the different stakeholders and participants in the organization, determines on rules and procedures for making decisions on the corporate affairs. Corporate governance is concerned with the processes, systems, practices and procedures as well as the formal and informal rules that govern institutions, the manner in which these rules and regulations are applied and followed, the relationships that these rules and regulations determine or create and the nature of those relationship .It also addresses the leadership role in the institutional framework. Corporate governance ,therefore, refers to the manner in which the power of a corporation is exercised in the stewardship of the corporation's total portfolio of assets and resources with the objective of maintaining and increasing shareholder value and satisfaction of other stakeholders in the contest of its corporate mission. It implies that companies not only maximize shareholders wealth, but balance the interests of shareholders with those of stakeholders, employees, customers, suppliers and investors so as to achieve long term sustainable value. From a public policy perspective corporate governance is about managing an enterprise while ensuring accountability in the exercise of power and patronage by firms.

In summary corporate governance is all about ensuring compliance with agreed minimum standards for the good management and stability of the organization. This requires clarity, focus and consistency of the stakeholders to achieve the standard set.

Factors that Determine success of Corporate Governance in an Organization

Working Board

A functioning Board represents the interests of shareholders in truth and in spirit. If a board exist it does not mean that it functions .Functioning of a board goes beyond setting. It must be able to set policies and define the large purpose of the business, approves strategic directions and hold executive accountable for performance. Board members must not own their seats to the benevolence of the executives they are meant to govern, if they would exercise objective judgements in the discharge of their duties. They must also be knowledgeable in the complexities

of the company and its industry, of finance and of relevant laws and regulations. If they lack expertise in their field cannot simply be effective partners in decision making.

Transparency

There is the need for transparency in the organization, in its day to day operations, its systems and decision making process. A culture of organization transparency is critical to sound ethical practice and corporate governance. Low level of organization transparency is usually the umbrella that hides abuse of power and unethical managerial behaviour. An organization that is not internally transparent to itself cannot be externally transparent to its shareholders and the larger public.

Whistle blowing

It encourages the confidential reporting of unethical practice among employees, suppliers' customers in their business dealing with the company. Are there clear hierarchies of whistle blowing up to the board level, usually an independent board ethics to report such malpractices. Are there sufficient safe guard to protect whistle blowers from victimizations? The perceived integrity objectivity and independence of the reporting hierarchy for whistle-blowing up to the board level is critical for whistle-blowing to work.

Power Concentration

The organization should have a system of check and balances. The organization should have a system of check and balances that ensure power is not concentrate in a few hands. A firm should not be run like a democracy; it should also not be run like an imperial kingdom. Imperialialness of power leads to abuse of power. You find in situation good men with good intentions have found themselves corrupted by power and end up abusing their office because the organization is not run by a system of checks and balances against power concentration.

Formal and Periodic evaluation of the CEO

The committee that reviews compensation should also have as one of its key responsibilities the annual review of the organization's succession plans for senior management. This process should involve a dialogue with the Chief executive about his or her strengths, weakness, objectives, personal plans, and of course performance. It should access the company's annual and long term performance in comparison with that of similar organization. Evaluating the CEO also helps to preserve his or humility, a trait that is difficult to come by. If you are unchallenged leader of a sizeable corporate entity. In the Nigerian content, applying this recommendation could face some resistance therefore it is advisable to entrench the process while the company is doing well and the CEO is enjoying accolades.

Formal and periodic evaluation of Directors

There must be periodic review of directors performance outside directors with management's input can appraise the performance of each colleagues for example five year intervals after the first appointment based on such reviews, directors who are under performing should not be nominated for re-election. If boards are to provide better governance, provisions must be made for the departure of directors who no longer pull their weight. Also advisable is to limit the length of service of any director to an agreed maximum number of years usually 12 to 15 years. This helps to encourage fresh thinking and minimize the negative impact of inbreeding.

Strong Market Institutions

It is important we build strong market institutions that will reward companies that are governed well through a lower investment risk rating; lower cost of capital and higher valuation. The trend

is seen on the Nigeria stock exchange. For this trend to continue, we must ensure that we reduce information asymmetries in financial markets get information that is true and factual to flow more freely among companies, shareholders and potential investors. Standard of financial reporting and transparency is expected to improve through the adoption of new IFRS system. This should be complemented with the adoption of common industry reporting standard among companies in the same sector to ensure better peer-comparison of companies performance. This will improve financial reporting transparency and reduce information asymmetries in our financial markets.

External Regulation and Monitoring

It is a fact that business should not be over regulated. The reason, due to recent experiences that without a regulator that monitors compliance of business to specified rules of engagement by society such business will not behave responsibly. The organization deploys its governance process as describe above, the regulatory environment can further compel companies to stick to high levels of corporate governance. It is important to have a regulatory environment in place which can compel companies to stick to high levels of corporate governance. It is also important where extant laws are logging behind ethical or governance challenges of corporations.

Disclosure of compensation policies and practices

It is important that compensation of managers and executives of the firm are in tandem with short and long terms value they have created for the organization. An important development is the need to ensure that a significant portion of executive compensation is deferred relative to maturity of their risk decisions especially in financial service. The quality of a loan decision cannot be asserted fully in its early years; managers should not be fully paid bonuses on profitability in loans created in early years because the quality of their risk decisions on such business may not be fully known until later years.

Open and well implemented conflict of interest policy

It ensures that interests of managers, executives and directors are disclosed when they enter into relationship with the company. This will be to ascertain that such business is fair to the firm, the larger shareholders and that such business interests are not in conflict with the fiduciary responsibilities of directors and in the case of managers that such interest are not in conflict with their duty as agents of shareholders.

Candour between executives of a firm and staff

It shows the good signal of quality of corporate governance if staff as internal stakeholders cannot express themselves with truthfulness; it might signal excessive power concentration at the top of the organization which can be potentially abused by leaders of the organizations. Candour between staff and executives of firms is also a critical ingredient that builds an internal culture of organization transparency. However people can ask and feel free to ask, nothing untoward can be hidden in the organization, ensuring a high degree of corporate governance.

Conclusion

The adoption of corporate governance principles in our organization is a giant step towards creating safe guards against corruption, mismanagement, promoting transparency in economic life and attracting more domestic foreign investment. The development of capacity in firms, government and civil society in developing systems and effectively monitor compliance will be critical to achieving the goal of corporate governance in our organization.

Reference

- Colley,J (2005) What is Corporate Governance? McGraw-Hill:New York
- Smerdon,R (2010) A practical Guide To Corporate Governance 4th Edition Sweet&Maxwell:United Kingdom
- Sanusi,J “Embracing Good Corporate Governance practices in Nigeria”keynote address by Former Governor of Central Bank of Nigeria at the 19th Annual Director’s Seminar organised by the Financial institutions Training Centre (FITC),Abuja 17th -19th June 2003
- Ahunwan,B “Coporate Governance in Nigeria” Journal of Business Ethics,Volume 37,Number 3,may 2002
- Al-Faki musa Good Corporate Governance:Essential for leadership and performance Excellence
- Vishnny,R (1997) A Survey of Corporate Governance” Journal of Finance 52(2):&37-783
- Chambers,A (2006) Corporate Governance Handbook 4th Edition Tottel Publishing:
- Pound ,J(1995) Promised of the Governed Corporation Harvard Business Review march 1
- Colley,J etal (2003) Corporate Governance McGraw-Hill:New York
- Cadbury Report on Financial Aspects of Corporate Governance in United Kingdom
- OECD (2009) Practical Guide to Corporate Governance: Experience from Latin American Companies
- Williams,S(2001) Corporate Governance Diversity and its impact on intellectual Capital performance in an Emerging Economy Mimeo,University of Calgary,Canada
- Coffey,B etal (1998) “Board diversity and Managerial control as predictors of corporate social performance” Journal of Business Ethics,17(14),pp.1595-1603
- Carlin,W etal (2002) International Evidence on Corporate governance: lessons for Developing Countries. Journal of African Economies 11(1):37-59
- Botha,de Villers J H (2001) Corporate Governance in state –owned enterprises: a developmental perspective. Paper presented at the Pan African Consultative Forum on Corporate Governance, Johannesburg, South Africa.16-18 July
- Oman,CP. 2001 Corporate Governance and National Development” An outgrowth of the OECD Development Centres Experts Workshop in 2000 and informed policy dialogue in 2001 sponsored in part by CIPE
- Cochran,P and Wartick,S (1988) Corporate governance: a review of the literature, Financial Executives Research Foundation,Morristown,New Jersey
- Centre for international Private Enterprise (2002) Instituting governance in developing and Transitional Economies: A Handbook

