

CORPORATE GOVERNANCE AND AGENCY THEORY

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Organizational Structure

As Martin (2006, p.122) asserts, organizations or enterprises usually adopt a structure as they grow and expand in order to simplify the operations therein and enhance efficiency. A formally established organization would thus have employees at the lowest level; these may feature both the skilled and unskilled workers who undertake the day to day operations in the firm. Above these workers are the departmental heads who are in charge of all operations in the various specific departments existing within an organization. Above the departmental heads are the line managers who oversee and manage the core lines that define the functional areas of the organization. functional areas may comprise of various departments and therefore, line managers may be in charge of various departmental heads. Above the line managers is the chief executive officer. The line managers report directly and act on the authority and directions of the CEO.

Every organization has a top level management team comprising of the CEO and the line managers. Some organizations have mid-level management team comprising of the various departmental heads. Above the top level management is the board of directors who interact and oversee the performance of the top level management in the organization. At the top-most level are the shareholders; these are the owners of the organization and to whom the board of directors directly reports. This structure defines roles and levels of authority within the organization. It also makes it possible for the business to undertake its operations even while growth may have yielded a vast and large volume of day to day operations. The structure also defines the levels of decision making which thus makes each person within the organization responsible over a specific cause. In absence of a structure as this, growth of enterprises would be greatly hindered and limited as increased operations would imply confusion and negative performance.

Corporate Governance

Corporate governance is simply defined as the policies, regulations, principles and guidelines that dictate how the board of directors for a company oversee the operations of the company through the management while consistently fulfilling the shareholders` objectives and pursuing the shareholders` best interest. (Muzata, 2021, P.295). Most business enterprises start small and through consistent positive performance experience growth to extents that cannot be handled by a single or few individuals. Over time, as the growth trend continues, the shareholders who are the actual owners of the enterprise have to acquire a management team to run the everyday operations of the business.

There however exists a challenge as the shareholders may be dispersed and unavailable all the time to meet the management team or may also have inadequate capacity to handle the different aspects of business needs. This necessitates the essence of a board of directors. The board of directors comprises of appointed individuals who basically represent the shareholders and are available to meet and discuss the business matters with the management whenever the need calls. In most cases, the appointed board members consist of individuals with vast experience in various business dimensions and are thus able to provide valuable insights to the management and hence fulfill the shareholders` aspirations. In this perspective, the board of directors may also be perceived to playing an agency role with shareholders as the principal.

Constituents of Corporate Governance

Corporate governance is complex and a diverse subject; to fully understand its essence, functionality and scope; it can be broken down to its fundamental constituents. The evaluation of what each constituent entails helps in breaking down the complexity of the subject into relatable

elements. People are the core of corporate governance. Corporate governance entails policies, guidelines and principles that are set around people at the board and management level within the organization. The shareholders, board directors, CEO and top management all comprise of people. In this regard, it is essential to note that people exhibit various attributes; some may be beneficial or enabling certain aspects of corporate governance while others may be limiting.

Corporate governance also entails processes. These refer to the set procedures or outlined ways specific to the organization in undertaking certain endeavors. Almost all activities in an enterprise follow a given process. The processes are set up to ease the way the people involved undertake certain activities without deviating from the ideal path that may also result in risks or loss. Processes differ across organizations even where they may be engaging in similar activities. Without set processes, organizational management and governance would turn chaotic and growth would not be feasible.

Purpose is also a constituent of corporate governance and it details the essence or reason for which each process or activity is undertaken. Purpose is the core detail engrained in each person involved in the organization management as well as the board that enables them undertake their responsibilities with a guiding goal in mind. Purpose also yields accomplishment and evaluation criteria for all corporate governance pursuits. Ultimately, there is performance which basically refers to the fulfilment level in the corporate governance engagements. All activities within corporate governance have to be subjected to performance evaluation to determine if the corporate governance purpose is effectively fulfilled. (Swain, 2020, p.126).

Principles of Corporate Governance

As corporate governance emerges as a complex and yet a highly essential part of the organization, there are certain principles that are associated with effective corporate governance. The board directors ought to portray these attributes as such would imply that they have the capacity to fulfill their purpose or agency duty to the principal; the shareholders. (Vitolla, Raimo and Rubino, 2020, p.1158). Principle of participation gives all board directors the capacity to voice their views and opinions. It is essential to note that each board member has unique insights based on their background, expertise and experience. As such, the board fully achieves full capacity through utilizing all the board members' contributions. Participation of the board members must however not violate the set procedures.

Legality determines the alignment of all board activities with the laws of the land. This implies that the board actions should not contravene any of the constitutional Acts. Integrity refers to the board directors' ability undertake their roles without compromise. The board members cannot engage in corrupt dealings while undertaking their roles. Transparency refers to the openness of the board especially to the shareholders. It also implies openness of the board members among themselves on matters concerning their mandate and roles as board members. Responsibility and accountability refer to the individual and overall level of taking ownership of one's actions. It also implies that board remains accountable to shareholders on all matters pertaining to corporate governance. Effectiveness and efficiency principle implies that the board must endeavor to enhance effectiveness and efficiency in the organization as this entails utilization of the shareholders' resources to generate valuable returns for them. The listed principles basically govern the board of directors in their agency role on behalf of the shareholders.

Agency Theory in Corporate Governance

The Agency theory defines the relationship between the board directors as the agents and the shareholders as the principals. The board members are appointed by the shareholders as their able representatives in the business; entrusted to make decisions and initiate action plans in the best interest of the shareholders. As such, the agents undertake a very important role that can be accomplished if and when certain conditions are fulfilled. The agents as well as the principals have obligations to each other that enables this relationship to exist and yield the desired results. The agents are expected to be diligent in their role by consistently ensuring that the management's decisions are all geared towards maximizing value and growth of the principal's resources. The agents are also expected to ensure that their decisions and activities do not raise any conflict of interest while serving the interests of the principals. The principals on the other hand must ensure that attractive and competitive compensation is given to the agents as motivation for their work. Similarly, the principals must ensure to appoint agents with the capacity to produce the desired results; as such the personal traits and qualifications of the agents must be clearly outlined and related to the cause for which they are hired. Cole and Schneider (2020, p.112).

As part of the agent-principal relationship, there are also consequences that apply especially to the agents in regard to the performance of their roles. The principal's expectation is that the agent acts in the best interest to secure and enhance value and growth of the principal's resources. This places a huge responsibility on the agents. In the event that the agents contravene this expectation and place their personal interests above that of the principal, legal actions may be taken and such may include hefty fines to compensate the principal. The principal must also set an assessment criterion for determining the efficiency and effectiveness of the agents in their

roles. Part of this criteria is in the overall organizational performance as noted through various metrics in the business operations. It is however observed that the agent-principal relationship mostly concerns the set expectations and obligations that the two parties have to each other; and the ultimate performance the organization.

Conclusion

Corporate governance is indeed a complex endeavor in organizations; playing a vital role that shapes the overall organizational performance in the long term. Corporate governance is also an inevitable course for any business with steady growth right from start up as a mammoth of operations emerge and there is need to set formal and functional organizational structures. Overall organizational performance is closely tied to the efficiency and capacity of the corporate governance in any organization; this implies that the overall performance achieved by an organization is only as great as the corporate governance is. The board directors are in an agency relationship with the shareholders; who are the principals. As much as there are various expectations that the principals have on the agents; there are similarly certain obligations that the principals have in maintaining effective agents. The interaction of the obligations and expectations of the agents and the principals determines the overall effectiveness of corporate governance in an organization. Companies seeking to achieve efficient and effective corporate governance ought to ensure that there exist effective procedures of appointing appropriate board members and subsequently ensuring that there are structures that guide, enable and reward the board members adequately. This ensures that the board comprises of highly motivated members with great personal traits and capacity to deliver the agency role effectively. The impact of effective corporate governance is observed through the ultimate positive performance of the organization over time.

References

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