Corporate Governance: A Review of Concepts, Systems, Mechanisms and Historical Perspectives

ABSTRACT

Aims: *Corporate governance involves several key concepts that help define its scope and purpose.The objective is to review these concepts and explore how firms rely on them to implement effective corporate governance.*

Study Design: It is a conceptual review that explored the concepts of corporate governance, its systems and mechanisms as well as historical perspectives around the world.

Place and Duration of Study: Department of Business Administration, Faculty of Management Sciences, UsmanuDanfodiyo University, Sokoto, Nigeria,

Methodology: The study employed documentary and descriptive research methods to review concepts of corporate governance, systems, mechanisms and historical perspectives.

Results: *Our study discovered that understanding internal controls helps ensure compliance, minimize risks and safeguard the firm's assets. Similarly, executive compensation structures align management interests with shareholder value and external oversight through auditing and regulation which provides an unbiased assessment of the firm's financial reports. Our historical perspective of corporate governance highlighted significant milestones that have shaped its evolution. Importantly, these include reports and acts aimed at addressing corporate scandals and improving governance practices.We also discovered thatto improve corporate governance standards worldwide,global organizations like the Organisation for Economic Cooperation and Development (OECD) among others have played a number of roles in developing international guidelines and codes of best practice. Further, the study explored the dynamic nature of corporate governance in response to evolving economic, social and technological trends.*

Conclusion: *The study concluded that understanding the concepts, systems, mechanisms and historical perspectives of corporate governance is essential for companies and stakeholders to maintain transparency, accountability and sustainable performance.*

Key Words: Corporate Governance, Concepts, Mechanisms, Systems, Historical Perspectives

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1. INTRODUCTION

Corporate governance is a fundamental aspect of managing and running a firm. It encompasses the concepts, systems, mechanisms and historical perspectives that shape the way organizations are directed and controlled. In the main, corporate governance is simply how a firm is governed. Most times it is described as a three-legged stool with senior management, the board of directors and the owners of the firm all playing major roles (McRitchie, 2020). In addition, effective corporate governance is crucial in ensuring transparency, accountability and ethical behaviour within firms, ultimately promoting long-term sustainability and stakeholder trust.

The concept of corporate governance revolves around the idea of balancing the interests of various stakeholders such as shareholders, management, employees, customers, suppliers, government and its agencies and the society as a whole. It involves establishing structures and

processes that align management actions with the best interests of the firm and its shareholders.

This study delved into the key concepts, systems, mechanisms and historical perspectives of corporate governance, providing a comprehensive understanding of its importance and evolution over time. By exploring these aspects, we can gain insight into the frameworks and strategies that drive effective corporate governance practices in modern firms.

This paper is divided into three sections including this brief introduction. Section two reviews concepts, mechanisms, systems and historical perspectives of corporate governance while the last part is the summary.

2. REVIEW OF CONCEPTS, MECHANISMS, SYSTEMS AND HISTORICAL PERSPECTIVES

This section reviews concepts, mechanisms, systems and historical perspectives of corporate governance across the globe.

2.1 The Concept of Corporate Governance

There are many definitions of the term 'corporate governance' as there are many scholars and disciplines. In fact, perceptions and definitions of the term abound in the extant literature. The lack of consensus on the meaning of this concept stems from the fact that corporate governance is applicable to disciplines like Business Management, Finance, Economics, Law, Accounting, Leadership and Entrepreneurship. Similarly, the fact that different countries have different models of corporate governance implies that the definition of the concept also depends on the country that is under consideration (Durisin&Puzone, 2009; Mallin, 2009; Solomon, 2010). Further, the definition of the term also depends on the organisation or commission.

The subject of corporate governance may be treated in a narrow or broad manner, depending on the viewpoint of the policy maker, practitioner, researcher, analyst or theorist. Thus, scholars, policy makers, practitioners, analysts and governance pundits define the concept according to their accounting, economic, political, legal, academic and cultural perceptions. Whereas some scholars look at the term from agency theory (separation of ownership and control) perspective, others view it from a wider (stakeholder) perspective. Solomon (2007) concurs that the existing definitions of corporate governance fall along a spectrum, with narrow views at one end and more inclusive, broad views placed at the other. The narrow view restricts corporate governance to the relationship between a company and its shareholders. This is the traditional finance paradigm, expressed in agency theory. At the other end of the band, corporate governance may be seen as a web of relationships, not only between a company and its owners (shareholders) but also between a firm and a broad range of other stakeholders. Such a view tends to be expressed in stakeholder theory which is more inclusive, broader and gradually attracting attention as issues of accountability and corporate social responsibility are brought to the forefront of policy makers and practitioners.

Despite the differing views on the subject, Javed and Iqbal (2007) and Sanda, Mika'ilu and Garba (2010) posit that there is a growing consensus that corporate governance is concerned with the ways in which all parties (the stakeholders) interested in the manner the affairs of the firm is managed try to ensure that executive directors,managers and other employees take measures or adopt mechanisms that safeguard the interests of the parties.

Derwent and Jones (1996) view the subject as the relationship between shareholders and their companies and the way in which shareholders act to encourage best practice,for instance, by

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voting at AGMs and by regular meetings with company senior management. Increasingly, this includes 'shareholder activism' which involves a campaign by a shareholder or a group of shareholders to achieve change in companies. This definition emphasises the importance of shareholder activism as it allows an evaluation of institutional investors' views on their own role in corporate governance. Similarly, Mayer (1997) sees corporate governance as ways of bringing the interests of investors and managers into line and ensuring that firms are run for the benefit of investors.

To Shleifer and Vishny (1997:2), "corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment". Put slightly differently, the term refers to how investors get the managers to give them back their money. Similarly, the term can also be defined as the set of mechanisms both institutional and market-based that induce the self-interested controllers of a company to make decisions that maximise the value of the company to its owners (Denis & McConnel, 2003). To Javed and Iqbal (2007:1), "corporate governance is a complementary set of legal, economic and social institutions that are put in place to protect the interest of the owners of a firm". These authors see corporate governance as accountability to providers of capital. Hence, if corporate governance is defined from the perspective of the investor, it is seen as both the promise to return a fair reward on capital invested and the commitment to operate a firm efficiently (Gompers, Ishii & Metrick, 2003).

Most of these definitions are similar and belong to the narrow view spectrum as they focus on shareholder profit maximisation instead of long-term value maximisation that will satisfy the interests of stakeholders. Their major limitation stems from the fact that they reduce corporate governance to a single problem, namely, how investors protect their investments.

Recent studies see corporate governance not only as a concept that encompasses rules, regulations, legislation, structures, processes, accountability to shareholders but also accountability to stakeholders as well as socio-cultural, moral, environmental and ethical considerations. Thus, the broadest definitions consider that firms are accountable to the whole of society, future generations and the environment. It is in this perspective that Tricker (1994) asserts that the governance role is not concerned with the running of the business of the company *per se*, but with giving overall direction to the enterprise, with overseeing and controlling the executive actions of management and with satisfying legitimate expectations of accountability and regulation by interests beyond the corporate boundaries.

According to Tricker (1994), corporate governance addresses the issues facing boards of directors, such as the interaction with top management as well as relationships with the owners and others interested in the affairs of the company, including creditors, debt financiers, analysts, auditors and corporate regulators. This definition is focused on the board room but the scope is extended to include owners and accountability to a broader group of stakeholders than just the shareholders. This conceptual view is in concurrence with the stakeholder-oriented approach to corporate governance. Tricker's (1994) definition is corroborated by Oboh (2005) who argues that what constitutes an ideal corporate governance is the exercise of power over a firm's direction, concern for the effects of the firm on other parties especially the environment and the acceptance of fiduciary duty to be accountable.

Solomon (2007:14) defines the term as "the system of checks and balances, both internal and external to companies, which ensures that companies discharge their accountability to all their stakeholders and act in a socially responsible way in all areas of their business activity". In the same vein, Osaze (2007) sees corporate governance as the relationship among various

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participants in determining the direction and performance of corporations. Hassan (2010:19) defines corporate governance as “a system of governance which ensures that organisations are managed in an efficient, effective and transparent manner to achieve corporate and social objectives within the confines of the law, ethical standard and moral values”.

According to the Central Bank of Nigeria, CBN, (2014:3), corporate governance refers to “the rules, processes, or laws by which institutions are operated, regulated and governed”. By implication, it is developed with the primary purpose of promoting a transparent and efficient banking system that will engender the rule of law and encourage division of responsibilities in a professional and objective manner. This definition sees corporate governance as building credibility, ensuring transparency and accountability as well as maintaining an effective channel of information disclosure that foster superior bank performance.

In line with the broad views,Shaba (2016)sees corporate governance as a comprehensive framework that ensures fairness, transparency and ethics in the distribution of rights, privileges, roles and rewards among interested parties while being environmentally and socially responsible in the pursuit of sustainable corporate value maximisation. Good corporate governance helps to build a trustworthy, transparent and accountable environment necessary for fostering long-term investment, financial stability and business integrity, thereby supporting stronger growth and more inclusive societies (OECD, 2023).

To McRitchie (2020), corporate governance is regarded as the structure as well as the relationships which determine corporate direction and performance. The implication is that the corporate board is central and fundamental to corporate governance and its relationship with the major stakeholders (shareholders& their agents) as well as other stakeholders is imperative.

2.2 Corporate Governance Mechanisms and Systems

Corporate governance mechanisms are the policies, guidelines and controls to manage an organisation and reduce inefficiencies. Aljifri and Moustafa (2007) are of the view that corporate governance mechanisms and corporate governance systems are two different concepts. A corporate governance system is a country specific legal, institutional and cultural factors that shape the pattern of influence that stakeholders exert on managerial decision making. On the other hand, corporate governance mechanisms are the methods employed at the micro (firm) level to solve corporate governance problems based on the political process, economic and legal institutions in each country (Weimer & Pape, 1999).

Jensen and Meckling (1976), Fama (1980), Fama and Jensen (1983), Demsetz and Lehn (1985), Jensen (1986 & 1993), Shleifer and Vishny (1997), Weimer and Pape (1999), Denis (2001), Denis and McConnell (2003), Cremer and Nair (2005), among other scholars discuss several corporate governance mechanisms that may be employed to address several corporate governance problems. According to these scholars, corporate governance mechanisms can be broadly categorised into two- internal and external. Similarly, Sanda et al.(2010) argued that the corporate governance literature suggests that both market and non-market mechanisms could be employed to enhance the alignment of interests of managers and stakeholders. However, the contents of each category and the efficacy of each mechanism vary from one researcher to another.

Denis and McConnell (2003) also offer a dual classification of corporate governance mechanisms into internal and external. The internal mechanisms comprise of board of directors and ownership structure while the external mechanisms dwell on the takeover and the legal/regulatory system. Cremer and Nair (2005) concurred with Denis and McConnell (2003)

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when they argued that a variety of firm-level mechanisms are associated with the governance of the public corporation. These firm-level mechanisms can be classified into two broad categories - internal and external governance mechanisms. Block holders and the board of directors are often seen as the primary internal monitoring mechanism, while takeovers and the market for corporate control are viewed as the primary external mechanisms.

In their survey of corporate governance, Shleifer and Vishny (1997) discussed several corporate governance mechanisms but settled for two as the most effective i.e. legal protection for investors against managerial self-dealing and concentrated ownership by large shareholders. Jensen (1993) outlines four main categories of corporate governance mechanisms namely: legal and regulatory; internal control; external control; and product market competition.

Denis (2001) also identified four mechanisms: legal regulatory mechanisms that exist outside the firm; product market competition; internal control mechanisms within a firm including board of directors and ownership structure; and external control mechanisms such as takeover market. Denis' (2001) classification is in concurrence with Jensen's (1993). Farinha (2003) also presented a dual classification system in tandem with Denis and McConnell (2003). The first is external discipline mechanism which includes takeover threats, product market competition, managerial labour market and mutual monitoring by managers as well as legal environment and reputation. The author classifies the second category as internal discipline mechanism which includes large and institutional shareholders, board of directors, insider ownership, compensation packages, debt and dividend policies.

Weimer and Pape (1999) identified eight corporate control mechanisms: the prevailing concept of the firm; the board system; salient stakeholders able to exert influence on managerial decision making; significance of stock markets in the economy; presence or absence of an external market for corporate control; ownership structure; relationship between executive compensation and corporate performance; and time horizon of economic relationships. The authors then grouped the mechanisms into two: network-oriented and market-oriented systems. According to these authors, the paramount characteristic of the network-oriented system is that an active oligarchy group substantially sway managerial decision making via networks of relatively stable relationships e.g. through cross shareholding and interlocking directorships. This system is prevalent in Germany, France, Italy, East Asia and Eastern Europe where banks and family control are relatively important. On the other hand, the market-oriented system relies on active market for corporate control to influence managerial decision making. This kind of system is common in Anglo-Saxon countries, i.e., USA, UK, Canada and Australia where ownership structures are diffused.

The major limitation of a classification approach to corporate governance mechanism and/or system is that it is descriptive solely for enabling rough comparisons using a common set of system characteristics. Furthermore, no classification system is entirely unambiguous. Systems within one country group might show relevant differences and systems in countries attributed to different groups might display significant similarities. Another limitation of classification approach is that it places emphasis on quoted firms, simply because data to support such classification are mostly available for such firms (Weimer & Pape, 1999).

Corporate governance describes the way trust is shown, power exercised, and accountability achieved in corporate entities, for the benefit of their members, other stakeholders, and society (Tricker, 2021).

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2.3 Historical Perspectives of Corporate Governance

The historical perspective of corporate governance highlights significant milestones that have shaped its evolution. Its history is closely linked with the corporate form that has existed for a long time. The first joint stock companies emerged in Britain and Holland during the early seventeenth century in response to the rapidly emerging markets of the East and West Indies. In 1602, the Dutch East India Company was granted a royal charter with permanent capital and shares of unlimited duration. The British East India Company received its charter two years earlier (1600) from Queen Elizabeth 1 (Monks & Minow, 2008). A little over a century later, the British Parliament passed a law (the Bubbles Act of 1720) in response to speculative crash in the East Indies known as the South Sea Bubble. The act forbade unchartered companies to issue stocks.

Given this age-long history, one might expect that the issue of how corporations are governed would have been settled a long time ago. Hermalin (2005) however argued that the issue remains nagging for nearly as long as corporations have existed. There have been agitations, contentions and arguments about governance of corporations and how to improve it. This is because the legal entity status of owning property, suing and can be sued gives the managers power and discretion to appropriate wealth.

Available evidence suggests that managers may not be altruistic as to appropriate corporate resources for the overall interest of the owners and the society at large (Smith, 1776; Berle & Means, 1932; Jensen & Meckling, 1976). Although corporate governance issues have been in existence since Berle and Means (1932), the expression, corporate governance, is relatively new. Zingales (1997) argued that the term corporate governance did not exist in English Language until around 1970s. Hermalin (2005) asserted that the term corporate governance seems to have been used first by Richard Ells in 1960 to denote the structure and functioning of the corporate polity. In the immediate aftermath of the Wall Street Crash of Tuesday, October 29, 1929, (which precipitated a world-wide collapse of share value and triggered the great depression that resulted to ten (10) years of economic slump with catastrophic levels of unemployment across all the industrialised countries of the world apart from the Soviet Union), scholars such as Adolf Augustus Berle, Edwin Dodd and Gardiner Coit Means pondered on the changing role of the modern corporation in society. Berle and Means' monograph "The Modern Corporation and Private Property" (1932) continues to have a profound influence on the conception of corporate governance in scholarly debates today.

From the Chicago School of Economics, Ronald Coase's "The Nature of the Firm" (1937) introduced the notion of transaction costs into the understanding of why firms are founded and how they continue to behave. Fifty years later, Eugene Fama and Michael Jensen's "The Separation of Ownership and Control" (1983) firmly established agency theory as a way of understanding corporate governance. Agency theory's dominance was highlighted in the work of Kathleen Eisenhardt (1989).

After the Second World War, the United States witnessed economic expansion through the emergence of multinational corporations. Accordingly, Lorsch and MacIver (1989) studied and published influential monographs on the prominence of the multinational corporations and found that many large corporations have dominant control over business affairs without sufficient accountability or monitoring by their board of directors.

Consequently, the seeds of modern corporate governance were probably sown by the Watergate scandal in the United States. As a result of subsequent investigations, US regulatory and legislative bodies were able to highlight control failures that allowed several major

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corporations to make illegal political contributions and to bribe government officials. This led to the development of the Foreign and Corrupt Practices Act of 1977 in the USA that contained specific provisions regarding the establishment, maintenance and review of systems of internal control. This was followed in 1979 by the Securities and Exchange Commission (SEC) of the USA's proposals for mandatory reporting on internal financial controls.

In 1985, following a series of high-profile failure in the USA, the most notable one of which being the savings and loans collapses, the Treadway Commission was formed. Its primary role was to identify the main cause of misrepresentation in financial reports and to recommend ways of reducing the incidences thereof. The Treadway Commission Report published in 1987 highlighted the need for a proper control environment; independent audit committees and an objective Internal Audit Function. It called for published reports on effectiveness of internal controls. It also requested the sponsoring organisations to develop an integrated set of internal control criteria to enable companies to improve their controls. Accordingly, Committee of Sponsoring Organisations (COSO) was born. The report produced by it in 1999 stipulated a control framework, which was endorsed and refined in four subsequent UK reports namely; Cadbury, Rutteman, Hampel and Turnbull. While developments in the United States stimulated debate in the UK, a spate of scandals and collapses in that country in the late 1980s and early 1990s led shareholders and banks to worry about their investments.

In the first half of the 1990s, the issue of corporate governance in the US received considerable press attention due to the wave of Chief Executive Officer (CEO) dismissals (e.g.: IBM, Kodak, Honeywell among others) by their boards. The California Public Employees' Retirement System (CalPERS) led a wave of institutional shareholder activism - something only very rarely seen before -as a way of ensuring that corporate value would not be destroyed by the traditionally cosy relationships between the CEO and the board of directors by for example, the unrestrained issuance of stock options. Further, in 1997, the East Asia Financial Crises severely affected the economies of Thailand, Indonesia, South Korea, Malaysia, and the Philippines through the exit of foreign capital after property assets collapsed. Others include the infamous collapse of Bank of Credit and Commerce International (BCCI) in 1991; the Russian Financial Crises and other corporate debacles such as Adelphia Communications, AOL, Global Crossing, Ansett, Pan Pharmaceuticals, Lever Brothers, Cadbury, Tyco, Commerce Bank, XL Holidays and more recently, Silicon Valley Bank(Clarke, 2004; Okike, 2007; Sullivan, 2009, Shaba, 2016, Shaba &Maishanu, 2023). The lack of corporate governance mechanisms in these countries highlighted the weaknesses of the institutions in their countries.

In the United Kingdom, one of the early moves to address corporate governance issues was the establishment of the Cadbury Committee under the chairmanship of Sir Adrian Cadbury by the London Stock Exchange (LSE) in May 1991 to deal with the concerns of low-level financial reporting, inability of auditors to provide safeguard that users of financial information expected and the absence of clear framework for ensuring sound internal control and risk management practices among others. The committee produced the famous Cadbury code which serves as a watershed in the development of codes of corporate governance and international benchmarks for best practices around the globe. The Cadbury (1992) report was later succeeded by the Myners Report of 1995 which made recommendations on the relationship between institutional investors and company management and how it should be conducted, the Greenbury (1995) which focused mainly on directors' remuneration, the Hampel (1995) which reviewed the Cadbury Code, Higgs (2003) with a focus on the role of non-executive directors and Smith (2003) on audit committees.

Other efforts at improving corporate governance practices around the globe include: the enactment of the Foreign Corrupt Practices Act of 1997 in the US; the publication of the Basel Accords on Effective Banking Supervision in 1988 (Basel I) and 1998 (Basel II); the King's Report of South Africa of 2002; the issuing of the OECD Principles of Corporate Governance in 1999 (revised in 2004, 2019 & 2023); and the adoption of the Commonwealth Association for Corporate Governance (CACG) Principles for Corporate Governance in the Commonwealth in 1999 by the Heads of Government of Commonwealth countries in their meeting in Durban, South Africa (Ayininuola, 2007; Solomon, 2007, Shaba, 2016).

Yet, in the early 2000s, the massive bankruptcies (and criminal malfeasance) of Enron and WorldCom as well as lesser corporate scandals, such as Adelphia Communications, AOL, Arthur Andersen, Global Crossing among several others led to increased political interest in corporate governance. This led to the passage of the Sarbanes-Oxley Act of 2002.

3. SUMMARY AND CONCLUSION

Corporate governance is a critical aspect of managing and overseeing a firm's operations. It encompasses various concepts, systems and mechanisms that ensure accountability, transparency, and ethical behaviour within a firm. This paper also considered the historical perspectives that have shaped the development of corporate governance practices over time.In other words, it explored the evolution of corporate governance, tracing its historical roots and examining the various systems and mechanisms employed to ensure best corporate practices.

It went further to provide a comprehensive overview of the concept of corporate governance and related issues such as board structures, executive compensation, shareholder rights and regulatory frameworks. It demonstrated how these elements interact to shape the governance landscape across different industries and jurisdictions.

Drawing on both theoretical insights and empirical research, the paper offered valuable insights into the complexities inherent in corporate governance. It used real-world examples to illustrate the impact of governance practices on firm performance, stakeholder relations and long-term sustainability.

Moreover, the study explored the dynamic nature of corporate governance in response to evolving economic, social and technological trends. Understanding the concepts, systems, mechanismsand historical perspectives of corporate governance is essential for companies and stakeholders to maintain transparency, accountability and sustainable performance.

Corporate governance helps build trust, ensures responsible decision-making and ultimately contributes to the long-term success of firms. Overall, this study will serve as a comprehensive resource for students, scholars, practitioners and policymakers interested in understanding the complexities of corporate governance and its implications for modern business practices.

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