GBMR
Global Business and Management Research: An International Journal
Vol. 6, No. 3 (2014)

Holistic Approach to Corporate Governance: A Conceptual Framework

Oladipupo Luqman Salami[1], Satirenjit Kaur Johl[2], and Mohd Yussoff Ibrahim[3]
[1-3]Department of Management and Humanities,
University Teknologi Petronas,
Bandar Seri Iskandar, 31750 Tronoh, Perak, Malaysia
Corresponding author Email: diposalami@gmail.com

Abstract
Purpose: The purpose of this paper is to examine the current corporate governance practices and come up with new paradigm in corporate governance.
Design/methodology/approach: Reviewing existing literatures on corporate governance framework approaches.
Findings: Majority of the frameworks used to explain corporate governance failed to examine corporate governance from a more holistic perspective.
Practical implications: This proposed model challenge the corporate governance frameworks that tend toward protecting shareholder interest alone and call for holistic approach towards corporate governance that will consider and protect the interest of all stakeholders, encourage ethical practices and take cognizance of organization operations towards people and environment.
Originality/value: The study contributes to the corporate governance literature in providing an insight into holistic approach towards corporate governance.

Keywords: Corporate governance, holistic, ethics, economic, environment, social, triple bottom line

Paper Type: Literature Review

Introduction

The issue of corporate governance has been a reactive to corporate organizations failure. Corporate scandals can be traced to Medici Bank in 1494 when the bank managers engaged in profligate spending and due to lack of control mechanism the bank became insolvent. Likewise, in the early 1900s, Allied Crude Vegetable Oil Refining Corporation engaged in what is known as commodities trade scam. The company defrauded its clients, including Bank of American by making them believed that they engaged in vegetable oil transaction. The company secured loans and made money using its vegetable oil as collateral security. The company showed inspectors tankers of water with a bit vegetable oil on the surface making them to believe that the tankers are filled with vegetable oil. This fraud was later exposed and the company collapsed. In order to curb or eradicate these fraudulent activities among corporate organizations, corporate governance came into vogue in early 1970s (Cheffins, 2013). Despite the implementation of corporate governance among corporate organizations, corporate scandals persist. In early 2000s, corporate scandals such as the Enron, Worldcom, Anthur Anderson just to mention a few occurred. This occurrence of corporate scandals resulted to organizations failures and as a result of these failures, shareholders' interests are in jeopardy. These failures about corporate entities globally have increased concentration on corporate governance among professionals, academics, regulatory bodies and people in the industries. This global trend in corporate failure has raised concerns about why corporate organizations failed despite implementing and practicing of corporate governance. This question about why corporate entities fail despite having corporate governance in place has become a very disturbing issue in the corporate world.
A lot of approaches had been taken to analyze corporate governance, such as it is control mechanisms used to make the interest of principal or the owners of business to be in line with the interest of the agents or the managers of the business – agency theory (Jensen & Meckling, 1976). Van Ees, Gabrielsson, and Huse (2009) and Westphal and Zajac (2013) proposed behavioral theory of corporate governance. Forbes and Milliken (1999), Bainbridge (2002) and Mustakallio, Autio, and Zahra (2002) suggested that corporate governance is all

about decision making. Rezaee (2008), Veasey (2003) and Rossouw (2005) explained corporate governance from ethical perspective.

Some other studies have examined corporate governance from the perspective of different models such as shareholder versus stakeholder model (Hillman & Keim, 2001), (Heath & Norman, 2004) and (Charreaux & Desbrières, 2001).

Majority of the studies on corporate governance that used some of the above mentioned approaches typically focused on aligning the relationship between shareholders and managers. Trying to examine how each of the corporate governance mechanisms such as ownership structure (Connelly, Hoskisson, Tihanyi, & Certo, 2010), disclosure and transparency (Collett & Hrasky, 2005), and directors remuneration (Conyon, 1997); (Conyon & He, 2011); (Firth, Fung, & Rui, 2006) can have an influence on good governance.

Majority of the frameworks used to explain corporate governance failed to examine corporate governance from a more holistic perspective. Identifying this gap, this study intends to propose a holistic approach toward corporate governance incorporating behavioral and multi-disciplinary perspectives to corporate governance.

Definition of Corporate Governance

Corporate governance has different definitions, Margaret Blair defines corporate governance as a set of policies, way of life measures proportionately more than is customary. This measurement and others are deliberate, using specifications that anticipate your paper as one part of the entire proceedings, and not as an independent document. Please do not revise any of the current designations. and organizational procedure that guide corporate organizations' activities which entails – the way things are done, who supposed to do it, how it should be done, what are the things to be considered before doing it and the controls measure (Cornelius & Kogut, 2003). In another definition by Organization for Economic Co-operation Development - OECD (2005), corporate governance is the way and methods by which organizations are directed and controlled. Corporate governance spells out the rights and responsibilities among the member of an organization and also the regulations and methods for making decision (Co-operation & Development, 2005).

From the above definitions of corporate governance, it can be deduced that the concept of corporate governance is about conducting business operations with all integrity, fairness and transparency and disclosing all necessary decisions in accordance with regulations and to be accountable and responsible towards shareholders.

Corporate Governance Theories

Agency Theory

Agency theory is a main theory in Corporate Governance literature (Kholeif, 2009). The theory placed shareholders as the most important stakeholder (Lan & Heracleous, 2010); (Daily, Dalton, & Cannella, 2003). Chartered Institute of Management Accountants (CIMA) defined Agency theory as premise surrounding the relationships that exist between the owners (principals) of organizations and the managers or directors (agents) of organizations. The interest of agents might be in conflict with the interest of principal in achieving the organizational goal.

Shareholder Theory

Milton Friedman argued that if business organizations were to be morally responsible then, their moral obligations or social responsibilities will be nothing, other than shareholders wealth maximization. Shareholders entrust their capital to organizations' managers, they are expected to use the capital for only organizations' purpose to increase shareholders returns (Dittmar, Mahrt-Smith, & Servaes, 2003). Shareholder theory as proposed by Milton Friedman assert that corporate organizations' one and only one social responsibility is to use its resources and invest in business that will maximize its profits so far that, the business is open and free competition and with no deception or fraud (Lee, 2008).

Stakeholder Theory

Stakeholders are defined as any person (it can be individual or company) who is affected by organization's decisions or activities (Bryson, 2004). They are groups or individuals that benefit or harmed, and whose rights are violated or respected by organization operations (Freeman, 2010). Stakeholder theory is concerned with the idea that business organizations should be concerned about the interest of other stakeholders when taking strategic decisions (Mainardes, Alves, & Raposo, 2011). In contrast to shareholder theorists that called for shareholder wealth maximization, stakeholder theorists campaigned for satisfying stakeholders interests. From stakeholder perspective, shareholders are one of the important members of stakeholder. Shareholders have stake and are affected by organization's operations and achievement, same with other stakeholders such as employees, customers, suppliers, and environment and so on. The stakeholder theorists claimed that, as business owes special and particular duties to shareholders, it also has various responsibilities towards other stakeholders (Heath & Norman, 2004).

The Proposed Holistic Governance Framework

This study proposed a holistic approach to corporate governance framework, which attempts to integrate stakeholders' interests including shareholders, considering ethical behaviour among management, understanding how organization activities or operations affect environment, economic and social and government.

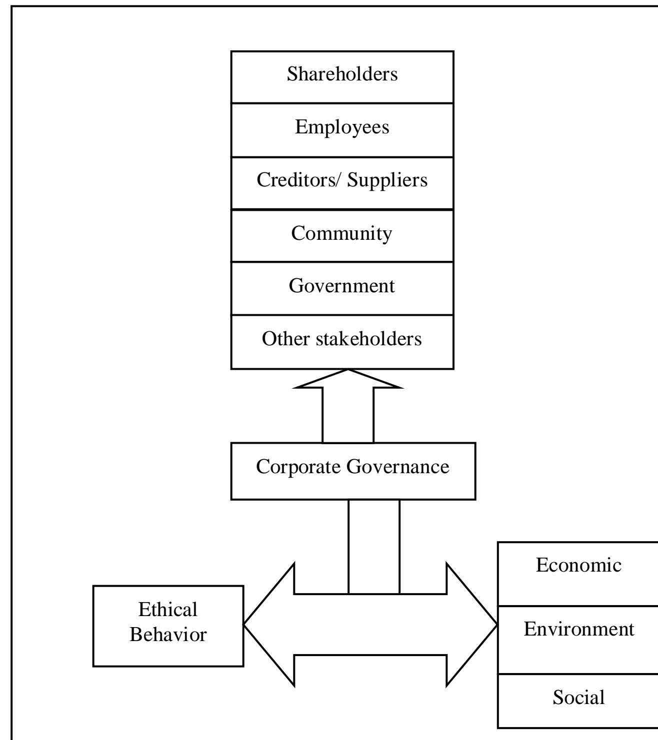

Figure 1: Basic components of the proposed holistic corporate governance framework

Stakeholders

As rightly defined by (Bryson, 2004) stakeholders are any person either individual or company that are affected by organization's decision or operations. They benefit or harmed, or their rights are been violated or respected by organization's operations (Freeman, 2010). Some examples of main stakeholders are: shareholders, creditors, employees, directors, suppliers, government, and the community from which organization tapped their raw materials. It takes two to tango. It is very hard for a single man to perform fraud in an organization. In an organization where employees wellbeing is taken seriously, and employees interest are been considered in decision making, there is possibility that it will be difficult for employee in such organization to collide for fraud. Likewise, organizations that give ethical instructions to their suppliers and that only associate their self with ethical suppliers; there is possibility that this will reduce the rate at which suppliers will source for resource unethically.

Ethicss

Ethics is a system of moral principles (Beauchamp & Childress, 2001). It is concerned with behavioral ideas regarding what is morally good or bad (Treviño, Weaver, & Reynolds, 2006). This holistic model proposed that ethics should be incorporated into corporate governance framework. Corporate governance is about how organizations are been controlled and directed. Who is behind organizational control and direction? Management, who are the management? People that are in charge of affair of the organization, therefore there should be moral principles guiding these people in the realm of affair to govern the organization ethically. Holistically, corporate governance should be concerned with moral behavior of people in the realm of affairs of organizations. The reason is that, these are people that make decisions for organizations. Hence, if they are of good moral, it will influence their decision on the organization. This could lead to better governance for organizations. Therefore, there is need to integrate or incorporate ethics into corporate governance.

Economic, Environment and Social

Economic, Environment and Social concerns are concept that was coined by John Elkinton in 1994 (Elkington, 2004). This concept holistically adds two more concerns, environment and social to organizations bottom line. In accounting, the phrase "bottom line" refers to organization's profit or loss, this is because both profit and loss are usually recorded at the bottom line of organization income statement (Henriques & Richardson, 2013). The

additions of these two concerns to bottom line make it to be referred to as triple bottom line. The argument for this concept is that, its shows organizations real economic profit (Henriques & Richardson, 2013). For instance, under the traditional accounting concept of profit, most organizations show profit after deducting cost of goods sold from net revenue and less other operating expenses. Meanwhile, the cost of generating the organization's net revenue might be more than the cost of goods sold and other operating expenses. For example, if an organization is into mining business, and during the cause of its mining operations, some of its employees have been exposed to asbestos which resulted to death of the employees and also their mine pollutes a river; hence, the cost to clean-up the river need to be accounted for and the cost incurred to treat those employees also need to be accounted before arriving at net profit. If not, the net profit for the year does not reflect the real profit for the organization.

Therefore, organizations need to first measure profit – the bottom line of the profit or loss account. The second bottom line is the organization's people account. This measures how socially responsible an organization is, in its operations toward its employees and other people in its environs. The third bottom line is the organization's planet account (Henriques & Richardson, 2013). This measures how environmentally responsible an organization is, in its operations towards the environment. Thus triple bottom line consists of profit, people and planet. Meanwhile, since the triple bottom line reveal the real economic status of organization, then it is worthwhile to embed the triple bottom line concept into corporate governance. This is because if organizations reveal the single bottom line profit to shareholders and in real sense there are other costs that needs to be accounted for but are not recorded, this does not show the real picture of the organization. That means the organization does not fully disclose its financial stand and this can result to fraudulent activities within the organization such as over stating the profit and under stating the expenses (Lamberton, 2005).

Conclusion

It is high time that corporate governance took a wider perspective, a perspective that does not focused on shareholders wealth maximization only but considering all other stakeholders. This model is to encourage managers to focus on economic activities of organizations and the same time not to forget that organization's true nature is that of a community of humans.

This proposed model challenge the corporate governance frameworks that tends toward protecting shareholder interest alone and call for holistic approach towards corporate governance that will consider and protect the interest of all stakeholders, encourage ethical practices and take cognizance of organization operations towards people and environment.

References

Bainbridge, S. M. (2002). Why a Board-Group Decisionmaking in Corporate Governance. *Vand. L. Rev., 55*, 1.

Beauchamp, T. L., & Childress, J. F. (2001). *Principles of biomedical ethics*: Oxford university press.

Bryson, J. M. (2004). What to do when stakeholders matter: stakeholder identification and analysis techniques. *Public management review, 6*(1), 21-53.

Charreaux, G., & Desbrières, P. (2001). Corporate governance: stakeholder value versus shareholder value. *Journal of Management and Governance, 5*(2), 107-128.

Cheffins, B. R. (2013). The History of Corporate Governance. *The Oxford Handbook of Corporate Governance*, 46.

Co-operation, O. f. E., & Development. (2005). *OECD factbook: economic, environmental and social statistics*: OECD.

Collett, P., & Hrasky, S. (2005). Voluntary disclosure of corporate governance practices by listed Australian companies. *Corporate Governance: An International Review, 13*(2), 188-196.

Connelly, B. L., Hoskisson, R. E., Tihanyi, L., & Certo, S. T. (2010). Ownership as a form of corporate governance. *Journal of Management Studies, 47*(8), 1561-1589.

Conyon, M. J. (1997). Corporate governance and executive compensation. *International journal of industrial organization, 15*(4), 493-509.

Conyon, M. J., & He, L. (2011). Executive compensation and corporate governance in China. *Journal of Corporate Finance, 17*(4), 1158-1175.

Cornelius, P., & Kogut, B. M. (2003). *Corporate governance and capital flows in a global economy* (Vol. 1): Oxford University Press.

Daily, C. M., Dalton, D. R., & Cannella, A. A. (2003). Corporate governance: Decades of dialogue and data. *Academy of management review, 28*(3), 371-382.

Dittmar, A., Mahrt-Smith, J., & Servaes, H. (2003). International corporate governance and corporate cash holdings. *Journal of Financial and Quantitative analysis, 38*(01), 111-133.

Elkington, J. (2004). Enter the triple bottom line. *The triple bottom line: Does it all add up*, 1-16.

Firth, M., Fung, P. M., & Rui, O. M. (2006). Corporate performance and CEO compensation in China. *Journal of Corporate Finance, 12*(4), 693-714.

Forbes, D. P., & Milliken, F. J. (1999). Cognition and corporate governance: Understanding boards of directors as strategic decision-making groups. *Academy of management review, 24*(3), 489-505.

Freeman, R. E. (2010). *Stakeholder theory*: Cambridge University Press.

Heath, J., & Norman, W. (2004). Stakeholder theory, corporate governance and public management: what can the history of state-run enterprises teach us in the post-Enron era? *Journal of Business Ethics, 53*(3), 247-265.

Henriques, A., & Richardson, J. (2013). *The triple bottom line: Does it all add up*: Routledge.

Hillman, A. J., & Keim, G. D. (2001). Shareholder value, stakeholder management, and social issues: what's the bottom line? *Strategic management journal, 22*(2), 125-139.

Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics, 3*(4), 305-360.

Kholeif, A. (2009). CEO duality and accounting-based performance in Egyptian listed companies: A re-examination of agency theory predictions. *Research in Accounting in Emerging Economies, 8*, 65-96.

Lamberton, G. (2005). *Sustainability accounting—a brief history and conceptual framework.* Paper presented at the Accounting Forum.

Lan, L. L., & Heracleous, L. (2010). Rethinking agency theory: The view from law. *Academy of management review, 35*(2), 294-314.

Lee, M. D. P. (2008). A review of the theories of corporate social responsibility: Its evolutionary path and the road ahead. *International journal of management reviews, 10*(1), 53-73.

Mainardes, E. W., Alves, H., & Raposo, M. (2011). Stakeholder theory: Issues to resolve. *Management Decision, 49*(2), 226-252.

Mustakallio, M., Autio, E., & Zahra, S. A. (2002). Relational and contractual governance in family firms: Effects on strategic decision making. *Family Business Review, 15*(3), 205-222.

Rezaee, Z. (2008). *Corporate governance and ethics*: John Wiley & Sons.

Rossouw, G. (2005). Business ethics and corporate governance in Africa. *Business & Society, 44*(1), 94-106.

Treviño, L. K., Weaver, G. R., & Reynolds, S. J. (2006). Behavioral ethics in organizations: A review. *Journal of management, 32*(6), 951-990.

Van Ees, H., Gabrielsson, J., & Huse, M. (2009). Toward a behavioral theory of boards and corporate governance. *Corporate Governance: An International Review, 17*(3), 307-319.

Veasey, E. N. (2003). Corporate governance and ethics in the post-Enron WorldCom environment. *Wake Forest L. Rev., 38*, 839.

Westphal, J. D., & Zajac, E. J. (2013). A behavioral theory of corporate governance: Explicating the mechanisms of socially situated and socially constituted agency. *The Academy of Management Annals, 7*(1), 607-661.