TOWARDS A DYNAMIC MODEL OF CORPORATE GOVERNANCE SYSTEMS

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The appropriateness of existing models of corporate governance adopted in achieving firms' mission is being questioned for its inadequacies in reducing agency problems. There is an increasing call for the adoption of a dynamic model of corporate governance system, which might help overcome the problems and limitations of the agency approach used in studying corporate governance systems.

The US sub-prime mortgage crisis of 2007 and consequent global economic crisis explicates the inadequacy of the existing corporate governance system. Corporate Governance is a system of rules, practices and processes within a firm through which it is directed and controlled to balance the interests of all stakeholders (especially shareholders and managers). It defines the division of wealth and power in a corporation. The call for a dynamic model is targeted towards developing a globally acceptable framework that takes into account a balanced view of human nature and behaviour that can be applicable in varying business contexts.

A popular framework in the context of corporate governance is the Jensen-Meckling (J/M) model of agency which is operational based on the Shareholder Value Maximization (SVM), and the agency role of managers to articulate the principals' objectives of maximising their financial returns on investment. Principals possess the ultimate decision rights concerning organisational goals, values, commitments, and identity; these are not just shareholders but the brains behind the establishment of the firm. On the other hand, the agents as fiduciary are expected to represent the best interest of the principals without recourse to self-interest.

The existing framework of corporate governance system in practice and academics has been delineated based on the agency assumption of the J/M model and studies have revealed the inadequacy of such arrangement. The J/M model emphasised the separation of ownership and control of a firm; the principals are differentiated from the managers. In such situation, there is high likelihood of conflicts of interest between the goals of principals and agents and this could lead to agency problems. The associated reduction in economic efficiency of firm consequently reduces the firm's financial performance. Hence, principals have to monitor, design, and implement financial incentives to reduce agency problems.

Recent realisations have also stressed the inadequacy of the agency arrangement of the J/M model. Empirical studies, over time, have presented little evidence that link governance structure and firm financial performance.

Also, alignment of the agent's utility with those of the principals appears not much associated with firm market value. The use of incentives such as stock options, bonuses and other monetary incentives to incentivise agents to focus on short-term quarterly benefits for shareholders while, the market value of the firm is being destroyed with consequential effect on the overall long run performance. Despite the inadequacy of the J/M model, the agency problem cannot be completely written. Hence, the need to focus on an approach that examines the realities as it concerns agency problems in corporate governance systems.

One property of social science is that they are artificial realities knowingly or unknowingly synthesised by humans. This explains the Principle of Double Hermeneutic (PDH) which links knowledge developed by social scientists to their audiences' decisions and designs. PDH implies that the knowledge developed by social scientists can become part of the knowledge that humans use in designing their artificial realities. Just like other social inventions of humans and phenomena studied in social science are artificial realities that are modifiable to suit current realities, corporate governance systems as designed for the purpose of monitoring and guiding firms control system are changeable to fit current realities. Therefore, it is important that corporate governance systems are treated as evolving institutions which are designed to monitor, incentivize, and strategically guide agents to fulfill the mission of the firm as desired by principals.

Achieving a dynamic model of corporate governance system revolves around the firm's mission as against the principals' goal. The mission of the firm should be designed to capture not only the goals of the firm, but also the values, commitments, identity, and guiding principles for decision-making of the firm. This will embody the goals of principals (for example, what products/services of value should the firm offer to consumers, what should the firm be known for; what are its distinctive identity and competences), as well as the goals of their human and capital providers. As a result, the firm becomes a human community pursuing a collective mission.

Within the dynamic framework, the firm's mission is such that it allows for flexibility in adapting to future opportunities and threats in changing organisational field conditions. As such, the corporate governance systems will be negotiated by both principals and agents to protect the interests of all stakeholders. The principals perform their functions by monitoring and providing incentives, resources, and strategic guidance to agents. The agents perform their function by providing information about firm operations to principals, making strategy suggestions to principals, and implementing the firm's mission.

No doubt about the possible weaknesses of the dynamic model of corporate governance system as suggested, but it presents a holistic analytical framework for understanding the functioning of corporate governance systems. A firm is part of a broader society and has its part to play in societal wellbeing. These corporate governance systems condition and guide agents' choices within the firm, and are aimed at helping agents achieve the mission of the firm.