CORPORATE GOVERNANCE PERSPECTIVES (SHAREHOLDER VS STAKEHOLDER PERSPECTIVE)

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Synonims

Corporate governance approach

Definition

The perspective of corporate governance is determined by the ultimate goal that the corporate governance system aims to achieve. The shareholder perspective advocates that the sole aim of corporate governance is to maximize shareholder value to protect the interests of shareholders. By contrast, under the stakeholder perspectives, the corporate governance system should be aimed at guaranteeing the interests of all the firm's stakeholders. Both perspectives should be regarded as complementary approaches, rather than competing positions. The stakeholder perspective broadens the scope of corporate governance. It supports that corporate governance systems should consider and balance the interests of all stakeholders, in which shareholders are a constituency with legitimate rights as those held by the other stakeholders. Additionally, the consideration of stakeholder interest could be used as an instrument to legitimize the corporation; hence, contributing to maintaining its existence for shareholders.

Introduction

The current United Kingdom Corporate Code, issued in July 2018, conceives corporate governance as it was originally defined in the 1992 Cadbury Report. According to this report, "*Corporate governance is the system by which companies are directed and controlled*. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to *shareholders on their stewardship*. The board's actions are subject to laws, regulations and the shareholders in general meeting" (Cadbury report, paragraph 2.5, emphasis added). This traditional definition of corporate governance regards shareholders as the sole constituency to whom managers should be accountable.

Although the shareholder conceptualization of corporate governance is still advocated by some academics and regulators nowadays (e.g. the abovementioned 2018 UK Corporate Governance Code), there is different approach to how corporate governance should be understood. Since the beginning of the 2000s, there has been several calls to broaden the scope of corporate governance, arguing that it should be a framework that governs "the structure of rights and responsibilities *among the parties with a stake in the firm*" (Aoki 2001 p. 11, emphasis added). Thus, all the constituencies that have a legitimate interest or are involved in the corporations, and not only shareholder, should be the focus of corporate governance. Letza et al. (2004) argues that each alternative corporate governance perspective leads to different practices regarding the establishment of corporate governance systems and mechanisms. Based on the two conceptualizations presented above, (shareholder versus all parties with a stake) the authors distinguish two polarized perspectives to corporate governance: the shareholder and the stakeholder perspectives. On the one hand, the shareholder perspective claims that the key aim of corporate governance is the protection of shareholder interests by maximizing corporate value. On the other hand, the stakeholder perspective advocates that the main objective of corporate governance is to guarantee the interests of all of the firm's stakeholders. Under this perspective, corporate governance is concerned with the configuration of relationships among all the constituencies that are directly or indirectly related to companies.

Both perspectives are the most relevant approaches for analyzing corporate governance systems. They rely on distinctive theoretical frameworks to represent the relationships among corporate actors and support the establishment of different mechanisms and measures as a means to achieve the goal of corporate governance (Letza et al. 2004). According to Ball et al. (2000), the shareholder and the stakeholder approaches to corporate governance are embedded in different business cultures of a country. The shareholder corporate governance perspective is related to common-law countries, such Australia, Canada, United Kingdom or USA. In these countries, firms are considered as tools to maximize the wealth of shareholders. By contrast, the stakeholder perspective is related to code-law countries, such as France, Germany or Japan. In these countries, stakeholders are considered to be legitimately entitled to have an interest in firms.

Shareholder perspective

Under the shareholder perspective, the goal of corporate governance systems is to protect the interests of shareholders and maximize their wealth. According to Letza et al. (2004), this perspective considers corporate governance a private issue that supports the rights of shareholders as corporate owners and the obligation of the company to meet their interests. Therefore, under this approach, corporate governance comprises instruments and mechanisms seeking to guarantee that managers effectively allocate the resources of the company to increasing profits and consequently maximize shareholder value (Bushman and

Smith 2001). This perspective is the classical approach to corporate governance and it has historically been the one supported by corporate governance codes worldwide.

The shareholder perspective is grounded on classical theories of corporate governance, such as agency, stewardship and resource dependence theories (John and Senbet 1998, Kiel and Nicholson 2003, Van den Berghe and Levrau 2004). These theories study the corporate governance factors that could affect shareholder value, as the final measure of the success of corporate governance. Shareholders (principals) of most modern companies delegate the day-to-day running of their firm to managers (agents). This situation creates a divide between ownership and control (Berle and Means 1932). In this context, agency theory advocates that agency problems could appear because managers may behave opportunistically to satisfy their own interests at the expense of shareholder value (Jensen and Meckling 1976). A contract should then be established between shareholders and managers. Corporate governance mechanisms should monitor that the former respect the contract. Conversely, stewardship theory suggests that managers are not always naturally inclined to commit opportunistic actions because they could have intrinsic and personal motivations to protect shareholder interests, such as reputation, success, social recognition (Donaldson and Davis 1994). Additionally, managers are expected to possess appropriate knowledge and skills to make the correct decisions in order to enhance shareholder value Finally, resource dependence theory argues that managers and directors may provide companies with access to the appropriate resources to improve financial performance as a consequence of their contacts, their expertise, and their links with the environment (Pfeffer and Salancik 1978).

Several corporate governance mechanisms contribute to achieving the goal of the shareholder perspective of corporate governance. These mechanisms fall into two categories: internal and external (Fernández and Gómez 1999). The most relevant internal mechanisms are the annual general meeting of shareholders, the board of directors, the incentive system and the ownership structure. The annual general meeting is the governing body of corporations and represents the rights of all shareholders. The board of directors is responsible of monitoring managers and should provide them with adequate strategic advice. The incentive system should incentivize the alignment of the interests of managers and shareholder by linking the remuneration of the former to the maximization of value for the latter. Finally, the ownership structure could contribute to minimizing agency problems if managers are owners of the company. External mechanisms are also useful in promoting the protection of shareholder interests. The most significant external mechanism are the legal and regulatory systems, the capital market, and the labor market. The legal and regulatory systems may develop rules and norms that compel managers to behave responsibly. In this regard, it is noteworthy that self-regulation is more common in countries of shareholder corporate governance systems because it has been proved more effective (Letza et al. 2004). The capital markets could also influence managerial behavior. The share price of the firm represents a good assessment for the performance of managers. The threat of takeovers could also have a significant impact on managers. Additionally, the labor market may discipline managers as their wages and possibility of being hired by other companies depend on how they perform.

Stakeholder perspective

Under the stakeholder perspective, the aim of corporate governance is to guarantee the protection of the interests of all of a company's stakeholders (Letza et al. 2004). This approach contrasts to the shareholder perspective because it broadens the scope of corporate governance by considering that stakeholder interests are comparable to those of shareholders. In so doing, the firm should try to increase the welfare of all stakeholders, and not just of its owners. This perspective emerged in the late 20th century, when several academics started to advocate that all the constituencies that affect and/or are affected by the activities of a firm have certain rights over it (Freeman 1984). Employees, customers, suppliers, creditors, the environment, and even society as a whole, may bear legitimate interests based on the stakeholder perspective of corporate governance. The recent inclusion of recommendation concerning stakeholders in corporate governance codes of some countries show the change towards a stakeholder conception of corporate governance (Szabó and Sørensen 2013). Further, some definitions of corporate governance explicitly recognize the relevance of stakeholders. For instance, John and Senbet (1998 p. 372) states that "Corporate governance deals with mechanisms by which stakeholders of a corporation exercise control over corporate insiders and management such that their interests are protected." By emphasizing the importance of stakeholders, this perspective strengthens the interrelated link between corporate governance and corporate social responsibility (Jamali et al. 2008). Corporate social responsibility aims to maximize "…the creation of shared value for their owners/shareholders and for their other stakeholders and society at large" (European Commission 2011 p. 6). Therefore, CSR represents a strategy that could help to fulfil the goal of corporate governance under the stakeholder perspective.

The stakeholder perspective is theoretically grounded on Freeman's (1984) stakeholder theory, which argues that firms should be accountable to and managed for the purpose of the benefit of all stakeholders, and not only of shareholders. Therefore, given that there could be different and competing interests among stakeholders, corporations need to properly balance their demands (Sternberg 1997). Following Donaldson and Preston (1995), Lezta et al. (2004) identified two streams of the stakeholder theory. The normative stakeholder theory regards the fulfilment of stakeholder interests as the "end" and emphasizes the significant role of corporations in society. The instrumental stakeholder theory regards the consideration of stakeholder interests as a "means" to legitimate corporate actions and increase corporate value. The latter is particularly related to the most prevalent approach to CSR, the instrumental approach, which considers CSR (and consequently stakeholder management) as a means to increase corporate wealth.

Internal mechanisms are more effective when considering the stakeholder perspective of corporate governance (Letza et al. 2004). Boards of directors play a relevant role in how firms respond to stakeholder interests by fostering corporate social responsibility policies (Khan et al. 2013) as they should provide managers with strategic advice. As a consequence of the growing importance of corporate social responsibility within overall corporate strategies (Porter and Kramer 2006), new corporate governance appeared, such as corporate social responsibility committees and sustainability reporting, with the aim of managing stakeholder interests (Money and Schepers 2007).

Reconciling both perspectives

The shareholder and the stakeholder perspectives of corporate governance may be regarded as competing approaches because they represent two polarized and antagonistic positions: satisfying the interests of the rest of the stakeholders could imply that the firm gives less attention to shareholder interests (Lezta et al. 2004). This opposing relationship could be even more apparent when considering stakeholder theory in its most extreme and orthodox conception. According to Sternberg (1997), by focusing on the need to balance the interests of all corporate stakeholders, stakeholder theory avoids favoring one constituency over the others, as could be the case of shareholders under the shareholder perspective. She argues that stakeholder theory completely removes the possibility of achieving the objective of the shareholder perspective as it jeopardizes the rights of corporate owners.

Letza et al. (2004) suggest that, although this opposing view could be the most likely to be initially apparent, supporting one perspective does not actually exclude the other. None of them is superior to the other as they are not capable of explaining the reality of corporations individually. They argue that we need to critically reflect on the arguments and key points of each perspective to understand the dynamism that exists between them, as well as the contextual process that characterizes their relationship. Corporate governance systems are continuously evolving and adapting to the values and characteristics of the societies in which they operate. Therefore, one could be more appropriate at particular moment of time, while the other may proof more adequate at a different point of time.

Furthermore, drawing on a less stringent approach of stakeholder theory, both corporate governance perspectives may actually be considered as complementary. The stakeholder perspective considers that the main objective of corporate governance is to guarantee the interests of all of the firm's stakeholders. However, in so doing, it does not advocate the protection of stakeholder interests at the expense of the protection of the shareholder interests. It extends the scope of corporate governance by considering shareholders a specific type of stakeholder, with rights equal to those held by others (Money and Schepers 2007). This approach is grounded on the instrumental stream of stakeholder theory. Given that the fulfilment of stakeholder interests is used as means to protect shareholder interests, it is possible to, at least partly, achieve the goals of both corporate governance perspectives at the same time. This interdependent relationship between the perspectives suggests avenues for future research regarding whether the traditional elements and prescriptions of the shareholder perspective hold or not for the stakeholder perspective (García-Torea et al. 2016).

Cross-references

→ See **Agency theory**

→ See **Codes of good governance**

→ See **Governance models**

→ See **Shareholder rights**

→ See **Stakeholder theory**

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