A WINNING GOVERNANCE STRUCTURE:
Basic components of a corporate governance structure that supports a winning corporate strategy and enterprise value enhancement.

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ABSTRACT

Corporate governance structure describes the arrogation of rights and responsibilities to key agents in the corporation, as well as the rules and procedures of engagement in corporate affairs. The governance structure also allows for the enactment of code of conduct, strategies and decisions of corporations. Some of the components of a corporate governance structure include shareholders, board of directors, characteristics of the board, board committees, management and the various levels of engagement and interactions amongst them. The size, characteristics, composition and interaction of these corporate actors determine the effectiveness of the overall governance structure and hence firm performance.
This working paper seeks to analyse and develop an appropriate corporate governance structure based on several studies on corporate governance literature, to achieve firm effectiveness and increased performance of modern firms.

Keywords : Corporate Governance Structure, Shareholders, Board of Directors

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1 Introduction

Corporate governance is the way corporations are directed and controlled, as well as "promoting corporate fairness, transparency and accountability" (Wolfensohn, 1999). It is founded on five fundamental principles, that (1) the interests of the various shareholders vary, (2) separation of ownership and control implies agency relationships, (3) interests of agents (executives) are different from those of shareholders, (4) monitoring the activities of agents is costly - hence, full monitoring is not optimal, and (5) the value missed due to imperfect optimal monitoring is a clear agency cost (Settles, 2005). Early theories like Berle and Means (1932) and Agency Theory postulate that the monitoring and control can only be separated through modern corporate governance structure.
The governance structure defines the allocation of rights and responsibilities among different participants in the corporation (such as board of directors, managers, shareholders, creditors, auditors, regulators, customers, and other stakeholders) and specifies the rules and procedures of engagement in corporate affairs. The structure is the frame through which corporations define and pursue their corporate goals, while taking into account the impact of its social, regulatory and market environment (Tricker, 2009). The governance structure is also a means of monitoring the conduct, strategies and decisions of corporations which allows for alignment of interests among the stakeholders (Zabihollah, 2002). The composition and interaction of these corporate actors determine the effectiveness of the overall governance structure and hence firm performance (Jensen, 1993; John and Senbet, 1998; and Shleifer and Vishny, 1997). This is a prediction and focus of the agency theory. However, some studies on stewardship theory challenge the conservative assumptions of the agency theory about the benefits of controls and indicate that, Boards with well connected executive directors achieve better than those that meet the theories of conventional governance thinking (Muth and Donaldson 1997). Studies by Donaldson and Davies (1994) and Burton (2000) also confirm this alternative view that structures designed to increase monitoring and control of management is normally associated with lower levels of corporate performance.
Despite the contrasting views presented by the two theories, the governance structures have played a significant role not only in monitoring and controlling executive behaviour, but generally in the direction and performance of modern firms. Governance arrangements and structures vary significantly across firms in many statutory authorities. These arrangements might differ even across sectors of the same market. The governance structures vary generally on the grounds of institutional,

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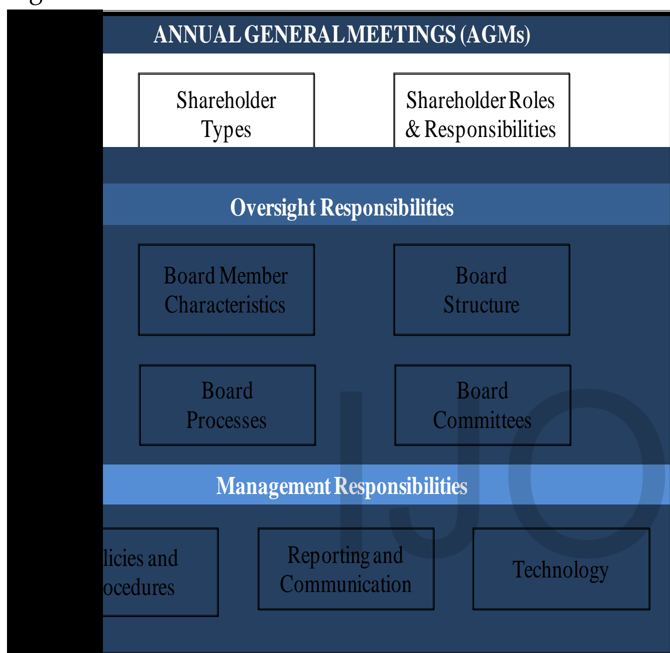
political and social traditions (Nestor and Thompson, 2008). Consequently, corporate governance structures must be developed in the context of the firm to achieve the needed organisational outcomes. This working paper proposes a generic but efficient structure based on the governance model in figure 1. The figure 1 below is a governance model based on the work by several researchers who have examined different corporate governance structures and their impact on firm value and performance in different countries.

Figure 1: Governance Model



Source: Researcher's Own Construct

2. Corporate Governance Structure

The figure 2 below describes the winning corporate governance structure based on an extensive research and experience over the years. It shows the various components of the governance structure and their relationships for an efficient corporate performance and value creation. It is worth noting that, the generic corporate governance structure has been developed in the context of an African country or any of the emerging economies.

Figure 2: A winning corporate governance structure

Source: Researcher's own construct; adapted from Seatles (2005)

2.1 Shareholders and Shareholders' Meeting

Shareholders are individual, company or other institution investors who own at least a share in the company. They are the company's owners, and therefore have a legitimate interest and stake in the governance of their corporations. They have become increasingly diverse within a complex and challenging markets, as well as the business and social environment, and are mandated by law to convene Annual General Meeting (AGM); the highest decision-making body of any company, to exercise their governance rights by voting to influence operational decisions of the company.

The primary role of shareholders in a typical efficient corporate governance model is to elect (with cumulative voting) directors who are fit, proper and capable of directing management in the best interests of the company and its shareholders (NACD, 2009) and dismiss directors where appropriate. Shareholders should receive sufficient information (e.g. identity, age & background, work experience, nature of relationship with company & its partners, financial status) to determine the ability of Supervisory Board nominees to fulfill their duties and, if applicable, to ascertain their independence. They are also required to monitor the board's activities and hold directors accountable for the fulfilment of their duties. They may also decide to become board members to improve their ability to monitor effectively, but in some jurisdic-

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tions and companies, the law does not permit them to do that, for example, financial institutions. At the AGM, the shareholders appoint Statutory Auditor as a regulatory requirement and for efficient corporate governance. They should be responsible for auditing the accuracy of the company's financial records. Moreover, every corporation should have a formal policy that describes the rights of voters and corporate actions which needs shareholder approval. Again, shareholder approval of takeovers, mergers, and buyouts should be required.

2.2 Board of Directors (BoD)

2.2.1 Board Member Characteristics

Persons with "full dispositive capacity" should be directors. The members of the board should comprise executive directors, non-executive directors and independent directors. The executive directors are those that hold an executive position in the company, namely the General Director, Executive Board member or manager of the company who is not an Executive Board member. Non-Executive Directors are Supervisory Board members that do not hold any executive position in the company. Independent Directors should be an individual who has not been in any of the following positions at the time of the approval of a business transaction, or during one year immediately preceding the approval of such a transaction: The General Director, the External Manager, an Executive Board member or a member of the governing bodies (Supervisory Board, General Director and Executive Board) of the External Manager; or a person with a family linkage with the External Manager; or an affiliated person other than a director of the company. In addition to the above, the directors should (a) have a wide range of skills, especially financial literacy (Chhaochharia and Grinstein, 2007), (b) be properly remunerated for better supervision (Becher et al 2005; Yermack, 2004) and (c) have long tenure which is a function of great experience and knowledge about the firm and its environment (Vafeas, 2003).

2.2.2. Responsibilities of the Board

The board's responsibilities should comprise at least the following five categories: oversight, fiduciary, legal, strategic direction and self-appraisal and renewal.

- Oversight: The board's job is to ensure that management carries out the strategic plan. They appoint the CEO or Managing Director and oversee its performance.
- Fiduciary: The board should provide the ultimate protection of authority and assets invested in the firm by shareholders. Directors bear ultimate responsibility for the success or failure of the company, and should be held accountable for actions taken that may not be in the company's best long-term interests.
- Legal Obligations: The board should ensure that the firm discharges its legal obligations and guards the firm from any avoidable liabilities and legal action.
- Strategic Direction: The board is to ensure the company's mission is clearly defined; re- evaluated periodically as well as ensures effective planning of firm's activities.
- Self-appraisal and renewal: The board should continuously evaluate the firm's activities in comparison with its competitors, access and responds to both domestic and external threats.

Governance structures and practices should be so designed to position the board to fulfil its duties effectively and efficiently. However, the effectiveness with which the board performs its management fiduciary and control functions may vary across boards as a result of different board structures, board processes and board committees.

2.3. Board Structure

The board structure involves board size, composition, leadership and the information between board structures (Maassen 1999). Though studies (Yermack, 1996 and Eisenberg et al, 1998) have shown no positive relationship between board size and corporate performance, others (Zajack 2001) also suggest that the size of the board of any corporate governance structure matters. Whilst larger boards are more difficult to coordinate, and may have communication and organisation problems (Forbes and Milliken 1999), a small board size experiences efficiency problems. In most modern corporations, the size of the boards varies from seven to eleven directors, with an average of about nine directors (Gillan, Hartzell & Starks, 2007). Some studies (Seatles, 2005) also tie the minimum number of directors to the number of shareholders with voting rights, for example, there should be least five directors for companies with 1,000 and fewer shareholders with voting rights and at least nine directors for companies with more than 10,000 shareholders with voting rights. According to Zahra and Pearce (1989), the decision on an ideal board size should be based on significant environment, strategic and performance factors. Weil, Gotshal and Manges LLP (2012) proposes the nature, size and complexity of corporation, as well needs stage of development should inform decision on the size of the board. Generally for most of the firms, board size ranges from seven to eleven directors, with an average of about nine directors, so ideally the board size of a winning corporate structure should be the average nine, according to Boone et al (2005).

The board composition specifies the different kinds of directors put together to form the board. IFF (2002) suggests that as a best practice at least 1/3 of the board should be non-executive, majority of whom should be independent. Studies confirm that a greater representation of outside board members (i.e. non-executive directors) is a key criterion for board's effectiveness, control and strategic functions (Byrd & Hickman, 1992; Rosentein & Wyatt, 1990; Coles et al. 2001). Hence for a winning corporate governance structure, 1/3 of the directors should be outsiders.

The next component of the board structure is the leadership of the board which may play some role in board effectiveness and firm performance. Though there is no evidence of any relationship between board leadership structure and firm performance (Florackis & Ozkan 2009), Cadbury Report (Cadbury 2010) suggests a conflict of interest with the CEO-Chair duality. At best, the position of the CEO and the Chairman of the Board should be separated to avoid further

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agency costs.

Whilst firm structure and leadership do not offer conclusive findings with respective to board characteristics and firm performance (Daily et al, 2003), another constituent for board's effectiveness is board processes. They refer to the behavioural dynamics of the board, i.e. customs, decision-making activities (including quality of board meetings), the formality of board proceedings and the interactions between executives and non-executives in and around boards (McNultty and Pettingrew 1999; Robert et al, 2005; Moxey and Berendt, 2008). Whilst ensuring that boards comply with the structures, the behavioural patterns above must be managed well to ensure that the directors are pragmatic in ensuring the rules are applied and avoid any negative consequences.

2.4 Board Committees

It is required by law and as a best practice for any corporation to create board sub-groups in the form of committees as part of its governance structure. These board committees are appointed standing or adhoc committees (Ghana Institute of Directors). The three most important board committees (regarded by regulators and investors) that are central to effective monitoring and control are the Nomination, Compensation/Remuneration and Audit Committees (Ellstrand et al 1999:68; John and Senbet, 1998; Gillan and Starks, 2000; Deli and Gillan, 2000). Though studies from Ellstrand at al (1999) and Conyon & Peck (1998) found little evidence to confirm any logical relationship between the composition of board committees and corporate performance as predicted by agency theory, it is prudent to appoint directors with a good blend of experience, skill and independence to increase its control and other fiduciary functions.

The Nomination Committee, chaired by an outside (independent) director, should consist of members appointed by the largest shareholders of the company and be approved at each AGM. The committee should be responsible for making recommendation to the AGM in the election of board members, the auditor and related remuneration matters. The existence of a nomination committee to select directors further strengthens the board's monitoring ability (Burton 2000).

The Audit Committee, to be chaired by an independent director, would monitor the performance of the board and that of the internal audit division, as well as review the report of the independent auditor for any necessary advice. Moreover, the integrity of the internal control and risk management system should be the job of this committee. The Cadbury report, for example, reiterates that the audit committees offer added assurance to the shareholders that, the auditors who act on their behalf are in the position to protect their interests (Cadbury 1992).

The Compensation/Remuneration Committee is charged with the responsibility of setting and reviewing the rewards of directors and executive officers. This singular role has the potential to minimise agency costs by restraining management from remunerating themselves with uneconomic levels of pay and debt (Burton 2000). Though there is lack of evidence so far between board committee characteristics and corporate performance, Conyon and Peck (1998) found that wherever there was a positive relationship between pay and performance, compensation/remuneration committee was involved.

Depending on the kind of industry the company finds itself, as well as the market and political environments, the following board committees are important if the board is to increase its oversight and fiduciary duties. These include (a) Business Ethics and CSR Committee – Ensure compliance and corporate ethics, and promote CSR activities, (b) Disclosure Advisory Committee – Discuss and examine important corporate information disclosure, (c) Safety, Health and Sustainable Development Committee – Ensure safety of company's staff at work and critically assess impact of company's activities on working environment, e.g. mining companies. (d) Investment Committee – assess investment opportunities including hospital takeovers, and (e) Party Politics Donation Committee – Provide support for political parties in its country of operation, especially for firms operating in Africa.

Besides all these, the board and its committees should carry out self-appraisals regularly in the interest of continual self-improvement. They should also provide an opportunity for the board and its committees to reflect and should result in a significant discussion about areas for further effort and improvement (Burton 2000).

2.4. Management Structure

In the corporate governance structure, the Board appoints the Chief Executive Officer (CEO) and other Executive positions to be in charge of the day-to-day management of the operations, deciding policies and measures related to business execution with assistance of Group Management. Management are then required to create the necessary infrastructure, comprising management committees, reports, measures, metrics, governance and risk oversight policies and procedures, management capabilities, as well as the enabling Information Technology and Communications (ICT) support for the firm. These executive decisions are generally complex and non-routine which are not directly responsible for firm performance due to many intervening factors such as stock market and political/economic environment of the country the firm operates.

3. Conclusion

The trend across the modern corporations is clear: companies rely heavily on governance structures to successfully

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move their corporate vision from just a conception to reality. Every successful multinational company has a governance structure because they believe in formal mechanisms for shared responsibilities and decision-making.

Corporations have different approaches in defining their governance structures, since agency problems between shareholders and managers vary across firms due to differences in firms' environments (political, industrial, social and technological) as well as the costs and benefits of monitoring those problems.

There are key lessons to be learnt across different contexts to inform researchers of the best available governance structure to ensure firm performance. These include,

1. every corporation should carefully define a governance structure that fulfils its political, cultural, performance and strategic objectives;
2. shareholders should elect competent members to the board, taking into consideration key board characteristics, i.e. wide range of skills, and greater experience and knowledge;
3. the board should be guided by its core functions, such as oversight, fiduciary, strategic and legal obligations;
4. board committees and board size should be carefully selected on the basis of best practices and the nature, needs, size and state of development of the corporation; and
5. Management should be given the room to function effectively but not without proper supervision and control by the board.

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