## Definitions of Corporate Governance in Business:

### Simple Definition of Corporate Governance in Business:

Corporate governance in the business context refers to the systems of rules, practices, and processes by which companies are governed. In this way, the corporate governance model followed by a specific company is the distribution of rights and responsibilities by all participants in the organization.

Governance ensures everyone in an organization follows appropriate and transparent decision-making processes and that the interests of all stakeholders (shareholders, managers, employees, suppliers, customers, among others) are protected.

**OECD Official Definition of Corporate Governance in Business**

The purpose of corporate governance is to help build an environment of trust, transparency and accountability necessary for fostering long-term investment, financial stability and business integrity, thereby supporting stronger growth and more inclusive societies.

**Corporate Governance Today – What Does It Mean?**

Corporate Governance deals with the way the investors make sure they get a fair return on their investment. In Corporate Governance, there is a clear distinction between the role of the owners of a company (the shareholders) and the managers (the executive board of directors) when it comes to making effective strategic decisions.

In today’s market-oriented economy and with the effects of [globalization](https://youmatter.world/en/definition/definitions-globalization-definition-benefits-effects-examples/), the importance of corporate governance is growing. This is due to the fact of governance being an important way of ensuring transparency that makes sure the interests of all shareholders (big or small) are safeguarded.

1. **What Is The Purpose Of Corporate Governance? What Are Its Benefits?**

**9 Positive Impacts of Corporate Governance in Companies**

A good corporate governance system:

* Ensures that the management of a company considers the best interests of everyone;
* Helps companies deliver long-term corporate success and economic growth;
* Maintains the confidence of investors and as consequence companies raise capital efficiently and effectively;
* Has a positive [impact](https://youmatter.world/en/definition/impact-definition/) on the price of shares as it improves the trust in the market;
* Improves control over management and information systems (such as security or risk management)
* Gives guidance to the owners and managers about what are the goals strategy of the company;
* Minimizes wastages, corruption, risks, and mismanagement;
* Helps to create a [strong brand reputation](https://youmatter.world/en/top-100-companies-best-csr-reputation2019-28108/);
* Most importantly – [**it makes companies more resilient**](https://youmatter.world/en/resilience-definition-meaning-examples-business-community/).

1. **Corporate Governance Models**

There are many models of corporate governance in the world and there is no universal best choice. The choice of the best model for a company depends on not only on its goals, motivations, mission and business context but also on their economic, legal, political and social frameworks. Nevertheless, there are 2 dominant governance models. Find them below.

**The Anglo-American Model Of Corporate Governance**

According to **[Ooghe and De Langhe](https://www.researchgate.net/publication/238325260_The_Anglo-American_versus_the_Continental_European_corporate_governance_model_Empirical_evidence_of_board_composition_in_Belgium)**, in Anglo-American countries, shareholders hold few percentages of the total number of shares that are publicly traded and most shares are in the hands of the agents of financial institutions. Moreover, in the USA and the UK, many companies are listed and their shares are publicly traded which means that there is little personal contact with their shareholders. Also, blockholders (owners of large blocks of companies’ shares) in the USA are less common than in Europe meaning that the shareholders’ voting power is smaller and therefore it’s not so relevant for companies to consider them.

Because of this greater focus on the interests of independent persons and individual shareholders, this model is commonly referred to as the shareholders model. Hence, in countries where most companies follow this governance model,  there is a higher individual power to hold shares and make investments in the capital markets. As a consequence, there’s a higher dispersion of capital and there isn’t a structured shareholder map.

In companies with this kind of governance structure, where there may be many shareholders, it is common to hear about the agency or stewardship theory. But what does this theory stand for?

**Agency Or Stewardship Theory: What Does It Mean?**

***“Broadly, agency theory is about the relationship between two parties, the principal (owner) and the agent (manager). More specifically, it examines this relationship from a behavioral and a structural perspective. The theory suggests that given the chance, agents will behave in a self-interested manner, behavior which may conflict with the principal’s interest. As such, principals will enact structural mechanisms that monitor the agent in order to curb the opportunistic behavior and better align the parties’ interests.”***

This old but recent excerpt from a [**paper**](https://pdfs.semanticscholar.org/b226/d681d20fb646b147ecb3f452fb5de2269cb7.pdf) written in 1991 by Lex Donaldson and James H. Davis provides a holistic view of this theory. Using business vocabulary, this theory means that pursuing the interests of the shareholders (that own a company) may not be of the best interest of the board of directors managing it.

This happens because the success of managers is commonly measured according to short-term goals whereas the shareholders are interested in the long-term performance of the company. The capacity for managers to act according to their self-interest is because they are able to influence strategic and investment decisions as they have more information available and are better aware of the context of the company.

On the other hand, shareholders may be many and disperse and sometimes see companies as one among many investments, lacking the knowledge about the situation or business context, being left vulnerable. Because of this, control mechanisms in order to ensure the long-term profitability and success of companies are needed.

**The Continental European Model Of Corporate Governance**

On the other hand, in Continental European countries such as Italy, France or Germany, shareholders groups hold large percentages of the total number of shares that are publicly traded and most shares are held by private companies, followed by financial institutions and in the last place by private persons.

In these countries, fewer companies are publicly traded and people tend to invest their savings on an individual basis, instead of betting on the capital market. This means that in this model there is a high concentration of capital in a few shareholders that made big investments and took big risks too.

This model is often associated with the stakeholder theory, as it also assumes the importance of companies having stakeholder engagement processes to strengthen the firms’ legitimacy to operate.

1. **Corporate Governance Structures:**

Corporations can have many different structures, but the most typical structure consists of the shareholders, board of directors, officers and the employees. The structure of corporate governance determines the distribution of rights and responsibilities between the different parties in the organization and sets the decision-making rules and procedures. It is usually up to the management board to decide how the company will develop. But what does truly influence the structure of a board of directors?

**What makes the structure of the Board of Directors?**

Boards – and directors – are not all the same. In fact, they face different challenges and their structure is shaped by different factors. A [**KMPG report**](https://home.kpmg.com/content/dam/kpmg/ng/pdf/advisory/bgc/bht/ng-enduring-across-generations-how-boards-drive-value-in-family-owned-businesses.pdf) synthesized some of the variables that can affect the foundations of a board:

* The legal and regulatory obligations of the relevant geography – which may range from a highly regulated environment that dictates board composition and responsibilities to no applicable laws at all, depending on the country in which the business is based.
* The company’s ownership structure – which may range from a business closely held by a few family members who see each other on a daily basis, to one with numerous, geographically dispersed distant family members, to the inclusion of other investors, either through private equity investment or publicly traded stock.
* The expectations and interests of key stakeholders including owners, other interested family members (such as the owners’ likely heirs), customers, and insurers.
* The company’s attributes – size, resources, maturity, culture, and level of complexity.

In the end, companies with a good corporate governance system, together with an experienced board that has a growth-mindset and sustainability concerns, will be better positioned to prosper both in the short term and on the long run.

1. **Corporate Governance & Sustainable Development**

First of all, it is important to clarify what sustainable development is. And according to the Brundtland Commission report, sustainable development is “the one that satisfies the needs of the present without jeopardizing the ability of future generations to meet their needs.” In order to achieve this long-term corporate sustainability goal, the sustainable development concept is built on top of three important “pillars” that must be fulfilled by companies: economic development, social equity, and environmental protection (check our [**complete sustainable development definition**](https://youmatter.world/en/definition-sustainable-development-sustainability/) for more information).

Although companies have been working on developing the economic “pillar” that has to do with production, sales, and profit, it hasn’t always been like this for the[**environmental protection and social responsibility pillars**](http://journals.euser.org/files/articles/ejes_jan_apr_17/Bistra.pdf) that are nowadays getting inside the companies’ agendas.

The environmental pillar has to do with managing pollution, waste or energy consumption issues and therefore re-optimizing value-chains. The social pillar has an external dimension that means companies making up for the communities where their activities caused some kind of damage or inconvenience. Inside the company’s workplace, it also means taking good care of the employees with fair wages and benefits, ensuring diversity and inclusion and respecting basic human needs and ethics.

Despite the ongoing debate about the meaning and application of sustainable development in a business context, it is common to assume that if a company is able to fulfill these 3 pillars, then it is a [**socially responsible corporation**](https://youmatter.world/en/definition/csr-definition/).

It is usual for these kinds of organizations to voluntarily information concerning their triple bottom line (another expression for the 3 pillars mentioned above) not only to prove they do the talk but also to gain a[**competitive advantage**](https://core.ac.uk/download/pdf/52057791.pdf). By its turn, this information that is provided is often called [***sustainability reporting***](https://youmatter.world/en/definition/csr-report-definition-meaning-benefits-examples/) and it can be done using standard frameworks like the *Global Reporting Initiative (GRI)*or ™, or simply by following methods and [**impact indicators**](https://youmatter.world/en/impact-measurement-good-business/) chosen by an organization.

There is no doubt that sustainable development has entered our lives and the way business is done. Indeed, because of it, management boards are rethinking the way they think and work, caring not only for the return rates of the companies’ shares and dividends or other issues that are commonly addressed by corporate governance but considering the society and the planet as well. For different reasons, they are integrating into their policies the [**3 dimensions of sustainable development**](http://journals.euser.org/files/articles/ejes_jan_apr_17/Bistra.pdf) and most companies nowadays have corporate social responsibility strategies and communication plans to share their goals within its employees and other stakeholders in the outside world.

Especially because of [**climate change**](https://youmatter.world/en/definition/climate-change-meaning-definition-causes-and-consequences/), some companies have been working hard on the environmental pillar, trying to prove to consumers that they are environmentally responsible so that their reputation is safeguarded and they can benefit from all that comes with it. This is one of the main reasons for the boards’ interest in the environmental performance of the companies they manage and why they’re disclosing information on these issues. This information is very useful to attract “[**socially responsible investors**](https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/from-why-to-why-not-sustainable-investing-as-the-new-normal)” that follow closely the behavior of these companies.

These changes in the world of corporate governance, that are indeed needed of the sake of a long-lasting world, show that sustainability is really growing in the companies’ agendas through the mindset of its leaders. In the end, companies that aim to last and thrive in the economic market and in the world need to consider sustainability. They need to report their sustainability practices and live by a sustainable culture that is aware that long-term profits need CSR policies if companies are to thrive and succeed. In this way, sustainable development must take part of the corporate governance of organizations.

**Source : https://youmatter.world/en/definition/corporate-governance-definition-purpose-and-benefits/**