

CH-2 VARIOUS THEORIES ON CORPORATE GOVERNANCE

Basis of Comparison	Agency Theory	Stewardship Theory
Propounder	Jensen and Meckling (1976)	Donaldson and Davis (1991)
Key Premise	<ol style="list-style-type: none"> 1. Managers are an agents of the owner(principal) 2. Managers (agents) are self-interested and opportunist. 3. Managers may not always act in the best interest of owners (principals). This is because of <i>moral hazard problem</i> (i.e. managers succumb to self interest and seek additional compensation through opportunistic means) and <i>adverse -selection problem</i> (i.e. shareholders cannot fully asses the abilities, intentions and motivations of managers before hiring them) 4. Information asymmetry is high. Managers possess more information than owners. 5. Interests of owners and managers diverge. 	<ol style="list-style-type: none"> 1. Managers are the stewards of the organization 2. Managers (stewards) are trustworthy and pro-organisational. 3. Managers act in the best interest of the organization. The steward benefits personally when the firm performs well. Their reputation and career advancement improves and may receive bonus, stock options etc. on demonstrating good results. 4. Information asymmetry is low. Managers willingly share information with owners. 5. Interests of owners and managers converge.
Owners-manager relationship	Conflict-prone due to divergent interests.	Cooperative and based on mutual trust.
Primary Goal	Aligning agent's interest with principal's interest.	Achieve organizational success through trust and empowerment.
Agency Costs	Significant (monitoring costs, bonding costs, residual loss)	Minimal or negligible.
Organizational culture	Control-oriented, formal.	Trust-oriented, participative.

Control mechanisms	Strong controls. Emphasis on monitoring, supervision, audits.	Minimal controls. Emphasis on reliance on trust and empowerment.
Governance Style	Compliance-based governance	Commitment-based governance
Role of board of directors	Independent board to monitor management.	Board to empower and facilitate the management
Leadership approach	Separation of CEO and chairman roles to reduce excessive control by management and increase independence of board.	Unifying the CEO and chairman roles as one person can be made responsible for both operational and governance functions and can craft a unified vision aligning board with management.
Incentives to Management	Extrinsic rewards such as performance-based pay, incentives, bonuses to reduce agency problems.	Intrinsic rewards such as recognition, responsibility, achievement.
Criticism	<ol style="list-style-type: none"> 1. Too much emphasis on shareholders and ignores interest of other stakeholders like employees, customers, suppliers. 2. Myopic view of human beings. Assumes managers are individualistic and self-centred. 3. Does not have universal application. Best suited for large corporations with dispersed ownership. 	<ol style="list-style-type: none"> 1. Emphasis only on employees and shareholders and ignores interest of other stakeholders 2. Overly idealistic view of human beings. Assumes managers always act ethically 3. Does not have universal application. Best suited for organizations with strong culture, shared vision, and committed leadership.

Basis of comparison	Shareholder Theory	Stakeholder Theory
Perspective	Economic perspective.	Ethical and social perspective.
Role of Managers	Managers are agents of shareholders	Managers are custodians of the interests of all stakeholders.
Focus	Shareholders are the most important stakeholders.	All stakeholders are equally important .
Primary Objective	Wealth Maximization	Shared Value creation
Purpose	To generate returns for shareholders.	To balance and satisfy the interests of all stakeholders.
Beneficiaries of Corporate Activities	Shareholders	Shareholders, employees, customers, suppliers, creditors, government, community, and environment.
Corporate Social Responsibility (CSR)	CSR is secondary and pursued only if it enhances shareholder value.	CSR is integral to business strategy and stakeholder welfare.
Board Composition	Directors primarily represent shareholders' interests.	Board may include diverse expertise and stakeholder representation.
Governance process	Control	Cooperation, coordination and conflict resolution.
Performance Measure	Profitability, dividends, share price, market value.	Economic, social, environmental, and governance outcomes.
Status of Employees	Resources for achieving shareholder objectives.	Important stakeholders whose interests deserve consideration.
Key Limitation	May ignore social and environmental concerns.	Difficult to identify, prioritize, and balance competing stakeholder interests.

Resource Dependency Theory vs Managerial Hegemony Theory

Resource Dependency Theory views the board as a strategic asset that helps the firm obtain critical resources and manage external relationships, whereas **Managerial Hegemony Theory** views the board as rubber stamps and argues that real power lies with managers and that boards merely ratify managerial decisions.

Basis	Resource Dependency Theory (RDT)	Managerial Hegemony Theory (MHT)
Originator	Developed by Jeffrey Pfeffer and Gerald Salancik (1978).	Developed by Mace (1971).
Basic Idea	Board-centred Theory. Organizations depend on external resources and Board helps to secure them	Management-centred Theory. Management dominates the Board and the decision-making.
Role of the Board	Board is strategic- provide access to resources, information, legitimacy, and networks.	Board is symbolic- mainly endorse decisions of management.
Status of Board	Board is powerful and active.	Board is weak and passive.
View of Directors	Directors are valuable because of their external connections and expertise.	Directors have limited influence and depend on managers for information.
Source of Power	Power comes from controlling critical resources and external relationships.	Power is concentrated in top executives and senior managers.
Purpose of Corporate Governance	To reduce uncertainty and secure resources needed for organizational survival.	To legitimize managerial decisions rather than control management.

Relationship with Environment	Focus on external environment .	Focus on internal managerial dominance.
Major Contribution	Explains why firms seek influential and diverse directors.	Explains why many boards fail to effectively monitor management.
Major Criticism	May overemphasize external linkages and neglect board monitoring role.	Underestimates the ability of boards to challenge management.