

POLD 707 CORPORATE GOVERNANCE

NAME: DOREEN KIRUNGI MAINA

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EVALUATION OF THE CAUSES OF CONFLICT BETWEEN SHAREHOLDERS AND MANAGERS

**Introduction**

The term “Corporate governance” relates to mechanisms by which a company organization or company is managed, administered and supervised where the owners of the corporate (the shareholders) don't participate within the day-to-day business of the corporate. Corporate governance has long been in relationship with the “principal-agent” or “agency” problem. A “principal-agent” relationship is when the one that owns a firm isn't the identical because the one that manages or controls it. As an example, principals (owners) hire managers (agents) to run their corporation on their behalf. Shareholders / principals need managers’ specialized human capital to come up with returns on their investments, and managers may have the investors’ funds since they will not have enough capital of their own to speculate. It’s therefore on this case that there erupts a separation between the investors and therefore the management of the firm, i.e. there's a conflict of interest between ownership and management, (see Berle & Means, 1932 as cited in Murphy, 1999).

It has long been known that in most big corporate organizations, the interest of the company managers more likely differ from the shareholders profit maximization goal. In these corporate organizations managers are appointed by the shareholders to create decisions and act within their interests.

Lasher (2008) says that this type of relationship creates a conflict of interest called agency problem. According to the ownership / shareholder objective, the key goal of the investment is to maximize shareholder wealth through allocative, productive and dynamic efficiency i.e. the first objective of the firm is to maximize profits. The standards by which performance is judged during this model can simply be taken because the value (i.e. shareholder value) of the corporate. It’s therefore on the premise that corporate managers and directors have a crucial obligation to make sure that corporations are managed within the interests of shareholders / owners. The underlying problem of corporate governance during this model objective evolves from the principal-agent relationship coming from the separation of beneficial ownership and executive decision-making. It’s out of this conflict of interest that causes the company’s behavior to diverge from the profit maximizing ideal. This happens because the interests and objectives of the principals (shareholders) and also the agent (the managers) differ when there's a separation of ownership and control. The actual fact that the company managers don't seem to be the owners of the company; they are doing not bear the complete costs, or reap the complete benefits, of their wrong actions. Therefore, although investors have an interest in maximizing shareholder value, managers may produce other objectives like maximizing their salaries, growth in market share, or an attachment to particular investment projects, etc.

Principal-agent theory’s central premise is that shareholders and company managers have different interests and objectives in addition as different access to specific information of a corporation. Agency costs mainly occur when ownership is separated from management, or when managers have objectives apart from shareholder value maximization. The “agency view” of corporations means the choices rights (or control) of a company should be entrusted to a manager, in order that the company manager can act within the interest of shareholders (Nwidobie, 2013). Partly as a results of this, mechanisms of corporate governance include a system of administrative and supervisory controls that are intended to place in line the incentives of managers with those of shareholders.

The “agency costs” term can seek advice from instances when an agent‘s behavior has deviated from a principal‘s interest. During this case, the principal would be the shareholder. There are differing kinds of agency costs which can arise due to contracting costs, or because individual managers might only possess partial control of corporation behavior (Nwidobie, 2013). They also arise when managers have personal objectives that are different from the goal of maximizing shareholder profit. Typically, the highest corporate executives are to blame for making decisions about high-level policy and strategy. Shareholders, on the opposite hand, are individuals or institutions that legally own shares of stock in a very corporation.

Typically, these people have the correct to sell those shares, to vote on directors nominated by various boards, and lots of other privileges. This being said, shareholders usually concede most of their control rights to managers. While attempting to learn shareholders, managers often encounter conflicts of interest. Below are the analyzed areas where conflicts of interest between corporate managers and shareholders arise:

* *Management Risk Assessment*

The corporate managers may be more willing to take on decisions that create situations where a company may be exposed to a greater degree of risk operating, financial or investing while shareholders desire maximized returns in the form of capital gains and dividends. Shareholders are very reluctant to take risks, and that is taken as being prudent and conservative. If the management team receives a large portion of its compensation in annual salaries and stock options, managers have less to lose because salaries are constant, and stock option values rise in response to increased volatility, a form of risk (Predic & Ivanovic–Djukic, 2010).

*Returns for Shareholders*

Shareholders desire minimized taxes, as critical maximization of shareholder wealth. Management teams sometimes exploit this by setting salaries in way over industry norms, presumably because compensation expenses are tax deductible and lower taxable income. It will be difficult to balance the return requirements of shareholders with different long-term goals and tax situations. The business could also form a thought that comes at the expense of shareholder returns. Common examples of such decisions include concerns regarding leaving a legacy, participating in "empire building," including the acquisition of businesses at a rapid rate, whether or not it includes taking on an unsustainable amount of debt or losing profitability.

* *Debt and Equity Control*

Management teams sometimes alter capital structures. The mix of debt and equity financing can be employed in ways that preserve a level of control rather than a mix that maximizes wealth for the shareholders (Principals). Another example may be the malformed and nonsensical amendments adopted by top executive / management team that purposely causes the company’s shares to lose substantial value in the event of a hostile takeover, offering high returns to shareholders at the expense of the company's leaders.

* *Capital and Debt*

There may more likely to be a constant tug-of-war between management and shareholders over the company’s capital. Shareholders often view excess cash on a company’s balance sheet and agitate for its return to shareholders in the form of cash dividends or the repurchase of shares, which boosts stock values. However, managers may be very hesitant to do so, sometimes rightly so. One should not repurchase shares simply to appease shareholders, but only when the company’s shares are undervalued.

Also, corporate management may want to raise capital to invest in new projects while shareholders view this as a threat. Issuing new shares can dilute existing shareholders’ stakes, and issuing debt can increase leverage risk and, therefore, the risk associated with the company’s stock. Shareholders should always read management reports on financing closely and examine the statement of cash flows to understand the methods of financing the business is using.

Other conflicts of interest analyzed were that Managers might also engage in self-dealing, entering into transactions that benefit themselves over shareholders. Managers might also purchase other companies to expand individual power, or spend money on wasteful pet projects, instead of working to maximize the value of corporation stock. Engaging into fraudulent practices, they may even manipulate financial figures to optimize bonuses and stock-price-related benefits.

**How good corporate governance practices can be used to ameliorate the situation of conflict between shareholders and managers**

The ultimate goal of excellent corporate governance is to eliminate instances when shareholders have conflict of interest with each other. Another important goal is to gauge whether a company governance system hampers or improves the efficiency of a company. After the high-profile collapse of variety of huge corporations within the past twenty years, several of which involved accounting fraud, there has been a renewed public interest in how modern corporations practice governance, particularly regarding accounting. Advocates of governance typically encourage corporations to respect shareholder rights, and to assist shareholders learn the way and where to exercise those rights (Tikvarovska, 2007). Disclosure and transparency are intertwined with these goals. In order to stop the managers to abuse their position and power and protect their interests, the stockholders may use several different mechanisms. Within the text that follows, the measures are divided into two groups first so analyzed:

a) **Internal measures:**

* Internal audit;
* Change in the salaries and payments of the managers;
* Concentrate ownership;
* Good corporate governance / management.

b) **External measures:**

* External audit;
* Market of capital;
* Law / legal frame.

*Internal Measures for Controlling of the Company*

To secure the continuity and therefore the development of the corporate, the inner audit is of the nice importance to be made. It helps to gauge the efficiency of the corporate, to detect and stop the eventually inefficient operations similarly on protect the assets and also the capital (Jovanova, 2014). Existing legal frame for the company sector within the Republic of Uganda provides internal audit within the business Law. One of the measures that may be taken to beat this agency problem is that the way of monetary rewarding of the managers. The most effective way is to calculate their bonuses as a percentage of the realized profit of the corporate. Why is that this rewarding method beneficial? The solution to the present question will be illustrated by an easy example of a situation once we ask an agent to assist us sell our computer.

At the start we will arrange with the agent a particular amount that he/she would get for his/her engagement for selling the pc. during this case, the agent won't have an interest to ask and acquire a more robust price for the pc from the potential buyer and he/she will only have an interest in exactly selling the pc as quick as possible so as to induce his/her money arranged previously. Even we, as sellers, are going to be in a very better position if we provide 10% of the reached value of the pc to the agent. This agreement makes the agent more motivated to achieve and sell the pc at a better price, which makes his/her commission bigger (Westerfield & Jaffe, 2008).

Accordingly, the identical will happen with the highest managers if their rewarding depends on the profit of the corporate. This kind of calculated rewarding will motivate the mangers to create decisions and take activities that lead toward the higher company profit-the goal that the shareholders strive to as their main interest. Another established practice is to supply the managers to shop for shares and become owners themselves. This can be the way of aligning the interests of the managers and also the shareholders-long-term development, continuity and increasing the worth of the shares.

Eun-Resnick (2004) indicate that concentrated ownership is a good thanks to prevent the agency problem. In keeping with them, managerial ownership share increases, their interest aligned with the shareholders interest, so that they will act during a way which will increase the shareholder value. A good system of corporate governance is of great importance for an efficient control of the businesses, for the enhancement of their performances, yet as for a far better approach and availability of the external financing.

Corporate governance could be a term that regards to the relations and roles of every and each party involved as inquisitive about the corporate. Within the code of conduct of the banks, corporate governance means standardization of the processes, the procedures and also the behavior of the businesses. The principles of the company governance are as follows: responsibility, transparency and control within the choice making process, still as reporting about the daily work of the corporate.

Larcker and Tayan (2011) characterized corporate governance because the set of control mechanisms that an organization adopts to avoid or dissuade potentially self-interested managers from participating in actions that are harmful to the welfare of shareholders and shareholders demonstrates how well corporate governance is aligned with the interests of stakeholders. Within the most cases there are an oversized number of involved and interested parties such as: shareholders, board of directors, board of managers, the managers, the govt., the staff, the clients, the suppliers, the regulation officers, the media, the investors etc.

*External Measures to Control the Company*

It is essential to obey home and international standards and rules of labor, so as for a corporation to grow and develop. These standards and rules can help controlling the work of the managers, along with prevention of the agency problem. One of the measures taken to manage the work of the corporate and stop the agency problem is an efficient external control of the work of the managers. The foremost effective way during this situation is to interact external audits who would periodically value the fact and objectivity of the company’s financial reports. Precise financial reporting is critical to ascertaining that the results are stated fairly and also the management has not manipulated results for private gain (Larcker & Tayan, 2011).

The audit reports are delivered to the shareholders, the managers, the workers, and to those who are involved at the market so as to use them as part of the valuation of the corporate. Market price of the shares of a corporation, consistent with which the corporate is valuated, could be a signal of a successful work of the corporate. If the corporate is governed by a manager whose decisions make the corporate less efficient, it can result in a situation when the shareholders would sell their shares.

As big the offer of shares is, as lower the worth gets, which should be a symbol enough for the members of the board of directors that some changes within the managerial department should be made. Nevertheless, it's vital to entails that in situation just like the previously mentioned one; firstly some analysis should be made, meaning whether the lower cost comes as a results of bad managing or as a results of the change of some external factors.

In conclusion, Miller (2005) states that there multiple solutions but none is ideal. Therefore, so as to beat or perhaps prevent this problem, it's necessary to regulate the work of the managers constantly and to create sure that the corporate works in accordance with the laws and also the international rules in financing.

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