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What is corporate governance?

In the first of a regular series on corporate governance, UCD's Prof Niamh Brennan explains what the term means.

The word governance comes from a Latin word – gubernare – which means to steer. Cicero has written 'he that governs sits quietly at the stern and scarce is seen to stir'. Thus my colleague, Dr Collette Kirwan, has conceptualised the board as being the navigator of the company.

In his *The Wealth of Nations* of 1776, Adam Smith noted that directors of companies are managers of other people's rather than their own money. He pointed to the risk that they wouldn't watch over other people's money with the same anxious vigilance as they would their own. And that is part of the problem with governance.

Corporate governance relates to the governance of companies. It is therefore important to understand the purpose of a company. Most people think it is to make profits. It isn't! You don't need to set up a company to make profits.

The reason for setting up a limited company is to get the benefit of limited liability. To encourage enterprise, society provides entrepreneurs with protection if their ideas go wrong in the form of limitation of liability through a company, meaning that their own personal assets are not on the line if the company gets into difficulties. The entrepreneur's liability is limited to the capital they've put into the company.

As companies serve to encourage entrepreneurial behavior, risk management is central to corporate governance. The board of directors' job is to manage the risks being taken.

Some view companies solely from the perspective of their owners. Broader, more modern thinking is to consider all stakeholders including, for example, employees, customers and creditors. A shareholder value model is arguably simpler than a stakeholder model of governance which has to take account of the interests of multiple parties, which involves trade-offs.

Corporate governance is about more than structures and systems. What is going on in the engine of the company underneath structures and systems is arguably more important, i.e., culture. There is a phrase that says culture eats strategy for breakfast. You could also say that culture eats corporate governance for breakfast. The culture, "the way we do things around here", depending on the organisation, can make it very difficult for things to be done properly. It has been said that the "geology" as well as "geography" of corporate governance needs to be considered.

There is a trade-off between entrepreneurialism and corporate governance. Processes and procedures around governance should not be so controlling as to impede the object of a for-profit organisation which is to engage in entrepreneurial activities to make a profit. Managing that trade-off can be quite tricky. People don't like rules and regulations. They want to be left to do things their own way. And, as we've seen with the banking crisis, that can have dire consequences for society.

Society gives entrepreneurs the gift of limited liability in return for which it is entitled to expect properly governed companies that contribute to the success of our society.

Niamh Brennan is Michael MacCormac Professor of Management at UCD and Academic Director of the University's Centre for Corporate Governance.

UCD's Diploma in Corporate Governance is a one-year part-time fully accredited programme led by Prof Niamh Brennan and her colleagues and is delivered over two 12-week semesters. The next programme begins in September.