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Niamh Brennan The long view

Corporations are neither bodies to be punished, nor souls to be condemned; they therefore do as they like.



Corporate governance, as the phrase implies, is about the governance of companies. To fully understand corporate governance, however, we must understand the nature of companies.

Purpose of companies

The primary purpose of companies is to provide the protection of limited liability to their owners (shareholders, members). This means that the liability of shareholders is limited to the capital they put into their companies. To be successful, risks must be taken. The thinking is that the provision of limited liability will encourage entrepreneurs to take risks, by establishing new businesses, which will employ more people, which will then create more wealth, to the overall betterment of society. Entrepreneurs' assets (house, car, yacht) are not on the line if the business fails. All entrepreneurs lose is the capital they put into the business. The capital contributed to businesses by their owners can be substantial. In a judgment in January 2015 in respect of Pierce Contracting (in liquidation) – which found in favour of the directors – the shareholders/directors put almost €15 million of their own money into the company (over and above the capital already tied up in the company) to try to keep it going.

Comparing companies and people

Companies are legal constructs – virtual entities. In law, they are treated as separate legal persons, separate from their owners. Companies, as separate legal persons, have features that distinguish them from natural persons. A comparison of some of the differences is illuminating. For example, a company can live forever whereas a natural

person cannot; a company can choose its nationality (i.e. where to incorporate) whereas a natural person cannot; and a company can avoid responsibility (i.e. blame its subsidiary or subsidiaries) whereas a natural person cannot.

The moral implications arising from these differences is colourfully captured by the British Lord Chancellor, Edward, First Baron Thurlow (1731-1806): “Corporations have neither bodies to be punished, nor souls to be condemned; they therefore do as they like.”

Companies have the potential to generate wealth, but they also have the potential to abuse their power at the expense of ordinary people. Limited liability is a privilege – a gift from society to encourage entrepreneurship – not a right. If limited liability were a privilege rather than a right, the State would have more power. It could threaten a company with losing its right to limited liability. This would concentrate the minds of company owners somewhat. The issue for society is the rights of individuals over overly powerful institutions. We should have laws that value the freedom of individuals over man-made institutions.

Role of company directors

Companies cannot act on their own. Corporate actions are executed by the board of directors. Thus, the behaviour of company directors influences the behaviour of companies.

To whom do directors owe their duty? Most people answer: “to the shareholders”. This is incorrect. Irish company law requires directors to look after the best interests of the company. Surely, they are one and the same? They are not! Understanding the distinction between the

company and its shareholders is critical to understanding corporate governance. Were directors' duty to the shareholders, this scenario would present them with the problem of which shareholders – those of yesterday, today or tomorrow?

Duty to the company results in a subtly distinct perspective. To keep the company alive warrants a longer-term, sustainable perspective with trade-offs between shareholders and the company. Thus, dividends to shareholders may be reduced to protect the long-term viability of the company, which in turn is in the interests of the shareholders in the long-term.

A further complication is that people think shareholders own the company. Shareholders are not owners of the company in any normal sense of the term. Rather, they own shares in the company. Thus, they do not have owners' traditional incentives to exercise care in managing the company. That duty of care is for the directors.

The directors of UK construction company, Carillion, which collapsed in January 2018, were fixated on maintaining dividend payments to shareholders. Arguably, this contributed to the collapse of the company. Would Carillion shareholders be happier had the directors kept the company alive rather than paying unaffordable dividends?

This is the trade-off directors must make between a long-term and short-term perspective, in the interests of the survival of the company.



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