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# STEWARDSHIP THEORY : IS BOARD ACCOUNTABILITY NECESSARY?

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**Subject** : Corporate governance

**Keywords** : board accountability, stewardship theory, agency theory, boards, directors

## **Abstract**

**Purpose** – the objective of the paper is to demonstrate that notwithstanding the fact that stewardship theory embraces things like trust of directors, their professionalism, loyalty and willingness to be concerned for the interests of others, as well as rejecting the foundations of classic agency problems that are asserted by agency theory, board accountability is as relevant to stewardship theory as it is to agency theory.

**Design/methodology/approach** – the paper applies the theory underlying board accountability in corporate governance, which is so often applied both in the corporate governance literature and in practice with agency theory in mind, to stewardship theory.

**Findings** – While the idea of accountability of boards is generally associated with an explanation and conceptualisation of the role and behaviour of directors as agents within classic agency theory, the paper demonstrates that board accountability is a necessary part of board life even if the role of directors is explained and conceptualised in terms of stewardship theory.

**Practical Implications** - The paper suggests some accountability mechanisms that might be employed in a stewardship approach

**Originality/value** – while many authors have talked in general terms about board accountability and its importance, this is the first paper that has engaged in a substantial study that links board accountability directly with stewardship theory and to establish that accountability is necessary.

**Paper type** : Research paper

## **1. Introduction**

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It has been stated on many occasions that accountability of boards of directors is important to corporate governance. In the United Kingdom's Cadbury Report (para 6.1), delivered in 1992, the central issue for corporate governance was said to be : how to strengthen the accountability of boards of directors to shareholders? The G20/ OECD's Principles of Corporate Governance state that : "The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders" (2015: Principle 7). It has been said that good corporate governance is able to be best achieved by focusing on the accountability of directors, and it can be argued that accountability of directors is the basis for the success of all other principles of corporate governance (Makuta 2009). It is widely posited that holding directors accountable for their behaviour and decisions is fundamental to good corporate governance (Solomon and Solomon 2004).

Agency theory, employed often in relation to corporate governance issues, is a theory devised to explain and conceptualise the role and behaviour of agents, including managers and directors of companies. It seeks to address the issue of what are known as agency problems, which exist as a consequence of the appointment of boards and managers in companies and the separation of ownership and control (Jensen and Meckling 1976; Fama 1980; Fama and Jensen 1983).<sup>1</sup> The separation occurs in large companies where those who are said to own the company, the shareholders, do not control it. Control is left in the hands of the directors and managers. According to agency theory holding directors accountable for what they do is one of the major issues of corporate governance (Filatotchev et al 2007). The theory holds that the central problem is ascertaining how the principals (the shareholders in corporate governance) can ensure that the agents (the directors) act in the interests of the principals rather than in their own interests (Pastoriza and Arinio 2008), given that, according to agency theory agents will seek to maximize their own personal interests when acting in such a role. Following on from that, many commentators have seen the existence of agency problems as the primary, or only, rationale for ensuring that the board of directors is accountable for what it does (Keay, 2014; Moore 2013). Agency theory has been the leading theoretical device employed in accountability studies to formulate hypotheses concerning the likely behaviour of those involved in accountability processes (Schillemans and Basuic 2015; Van Slyke 2006). The agency theory has not only been the leading paradigm in the financial economics literature (Hill and Jones 1992) and much of the governance literature (Dalton et al 1998; Nicholson and Kiel 2007), it has been said that it has given us the "dominant conceptual frame for accountability mechanisms" (Dicke and Ott 2007, 464). As a consequence it has been employed in many disciplines.

Some commentators have argued in the past 20 years or so, in particular, that stewardship theory offers an alternative way of conceptualising the principal/agent relationship and it has been applied to the members of boards and the managers of companies. The theory denies the existence of the problems identified and focused on by agency theory. Like agency theory stewardship theory endeavours to explain the role and behaviour of directors in achieving firm goals (Chrisman et al 2007). While, like agency theory, stewardship theory recognises a form of agency exists in the corporate setting, it differs in that it essentially holds that agents/directors who act as stewards will not be concerned about fostering their own economic interests, but will want to act in the best interests of their company and they will act in a way that leads to collectivist/organisational utility rather than self-serving benefits, and in working towards organisational ends their personal needs are fulfilled. Thus, there is an

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<sup>1</sup> The theory is generally used in a descriptive way than a normative one : Heath (2009).

alignment between director and company interests. If stewardship theory applies in a corporate governance setting and it can explain and conceptualise the role and behaviour of directors, then it causes one to ask whether it is logical to make any provision for boards to be accountable. Is accountability only relevant when we conceptualise directors and their approach to their functions and roles within the tenets of agency theory? Can it be argued that if there is a high level of trust in the board, on the basis of stewardship theory, there is not the same need for accountability? Is accountability only about making sure directors do not abuse their positions and cause loss to their companies and, if so, is, therefore, accountability of no relevance if stewardship theory accurately explains how boards of directors will behave in their management of companies?

## **2. Board Accountability**

Although, as noted at the beginning of this paper, accountability has been mentioned frequently in the corporate governance literature, and has been used in definitions of corporate governance as well as being relied on as a critical factor in corporate governance, there have been few attempts to explain what it actually means, certainly in the context of corporate governance. Before considering whether accountability is of relevance if stewardship theory is able to explain the actions of directors on boards, it behoves us to consider what accountability actually involves in this context.

Building on the work of many commentators in various disciplines, and primarily political science, ethics and public administration, and focusing on the corporate governance context, board accountability it has been said to involve several stages, which are preceded by the fact that boards must accept responsibility for what they do and the need to be answerable to others (Canadian Democracy and Corporate Accountability Commission). Unless boards acknowledge that accountability plays a critical part in corporate governance then there cannot be worthwhile and effective accountability. This is because boards can take action to hinder the effectiveness of many of the accountability mechanisms that are in place if they wished to do so. This part of the accountability element does not, of itself, require any action, necessarily, but is an attitude that should exist within a board.

Recently a study of board accountability has argued that accountability is a process and that there are four stages to it (Keay, 2015). The first stage is the board is required to provide accurate information concerning its decisions and actions, so that shareholders are informed as to what has been done. This part involves accountants (those accounting) disclosing and reporting, and certainly candid reporting is an essential element of this process (Licht 2002). This step involves the provision of information to the accountees and has been referred to as 'accounting for verification,' (Uhr 1993, 4) or 'informative accountability' (Kaler 2002, 328). The second stage involves a board explaining and justifying its actions, omissions, risks, and dependencies for which it is responsible (AccountAbility 1999). Often this is seen as the predominant aspect of accountability and is the stage that is focused on by many elements of the accountability literature. It is probably correct to say that explanation involves the accountant verbalising what has been done and how it has been done, and justification involves a statement as to why it has been done. The first two stages together might be said to contribute to transparency, another important aspect of corporate governance, but while they are significant they only take us so far. It is generally acknowledged that for accountability to be effective there must be a dialogue, and this is where the next two stages fit. The third stage is constituted by the questioning and evaluating of the reasons provided for what has been done by the board. Fourth, the final stage is that there is the possibility, but not the

requirement, of the imposition of consequences. This might simply entail feedback and may not necessarily constitute negative consequences, but on many occasions it will. The most extreme consequence would be, in jurisdictions where the law permits it, for the board or members of it to be dismissed.

An important issue that is beyond the scope of this paper is to whom the board is to account. For the most part legal systems that have one-tier boards provide that the board is accountable to the shareholders as a whole while those jurisdictions which have two tier boards, a management board and a supervisory board, the management board is accountable to the supervisory board which is in turn accountable to the shareholders (Keay 2015).

We now turn to consider agency theory in relation to accountability as it is often regarded as the primary rationale for making managers and boards accountable for what they have done or not done.

### **3. Agency Theory and Board Accountability**

In life, and particularly in business, individuals (principals) will engage agents to act for them as they do not have the time or the skills to do everything that needs to be done. An agency relationship will emerge any time an individual relies on the actions of other persons or body to complete a task (Pratt and Zeckhauser 1985), because the latter is more knowledgeable, has more time and they can save the principal money. The agency relationship has been classically defined by Jensen and Meckling as : “a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some services on their behalf that involves delegating some decision-making authority to the agent”(1976, 308). As it is not often possible to specify what a person wants the agent to do, the latter is given broad discretion. It is usually not feasible for the principal to monitor carefully the work of an agent. This state of affairs has led to the development of the agency theory, which was first developed in the financial economics literature and is discussed in a large number of works. It is based on the influential work undertaken by Fama (1980), and Jensen and Meckling (1976). The theory describes mutual contractual arrangements between two or more persons or organisations, or between persons within one organisation (Mahaney and Lederer 2003). The theory has been applied to various kinds of agency relationships, such as those between boards and managers and employees and their non-profit employers (Van Slyke 2006).

The theory has, over the years, gained more and more ground in relation to how managers and directors are viewed (Segrestin and Hatchuel 2011), and it has become the “dominant paradigm” (Davis et al, 1997a, 20) when it comes to corporate governance research. The theory is seen by some as the cornerstone of corporate governance, and it holds that, insofar as it applies to companies, that managers are the agents of the shareholders and are employed to run the public company’s business for the shareholders who do not have the time or ability to do so, and it is the shareholders who are best suited to guide and discipline managers in the carrying out of their powers and duties (Matheson and Olson 1992). The problem is that monitoring by shareholders is not a satisfactory solution to the problem because of the time, inconvenience, cost and impracticalities of undertaking such a task and shareholders are not effective monitors, and consequently accountability is necessary (Dooley 1992). The shareholders elect the board of directors as their agent (Onetto 2007; Blair and Stout 2001a) to undertake the monitoring and to oversee the work of the managers and executive directors (Onetto 2007; Blair and Stout 2001a), and to control misuse of shareholder funds and reduce management perquisites (Nicholson and Kiel 2007). The theory posits, relying on

reductionist assumptions of human motivation (Pastoriza and Arinio 2008), that directors cannot be trusted (Roberts 2001; Dicke 2002). This is because they are rational actors and self-interested utility maximisers who will seek to benefit themselves. The theory assumes they will engage in self-dealing and/or shirking; they will have no incentive to maximise the interests of the shareholders (Dooley 1992), and have no altruistic motives in anything that they do (Heath 2009). As a result, there will be conflict between the interests of the directors and those of the shareholders; the goals of each group will differ even though they are engaged in a cooperative venture (Eisenhardt 1989; Jensen 1993; Van Puyvelde et al, 2013). Some believe that agents are pure egoists and their behaviour is designed only to maximise their own interests. Williamson regards agents as “opportunistic actors given to self-interest seeking with guile” (1996, 53). These sentiments clearly underlie many elements of corporate governance systems around the world (Licht 2002). All of this means that accountability is needed to ensure that the board and individual directors act properly and fulfil their responsibilities and functions appropriately.

The general view of agency theorists is that if the activities of the agent/director is not controlled or restrained or the interests of the agents and the principals do not coincide then the agency relationship will be marked by agency problems (Van Puyvelde et al 2013). The theory is concerned with reducing the costs involved in imposing controls to make sure the agent’s opportunistic behaviour is curtailed as much as possible and traditionally this has been achieved through the devising of alternative compensation schemes and the use of governance structures (Jensen and Meckling 1976). Also, accountability may be seen as a critical element in the formulation of appropriate governance structures that limit the excesses of boards. Examples of accountability mechanisms in this regard are auditing and performance evaluations (Davis et al 1997a). Accountability is in fact often seen as a process that guards against the risk that agents will shirk or self-deal rather than perform their tasks in the interests of their principals (Licht 2002; Harlow and Rawlings 2007). Where principals delegate power to agents, agents are liable to account to their principals for the manner in which that power is exercised, and it is hoped that this will prevent any improper activity on the part of the agents.

Agency theory provides that the shareholders are regarded as the true owners of the company and they are the principals of the directors who act as their agents in running the company’s affairs (Pilon 1982; Keay, 2010). This is a view that was accepted by the Cadbury Committee and it effectively acknowledged agency problems when it said that there could be a risk of aberrant conduct on the part of the directors as they undertake their functions, and it can be mitigated by ensuring that the players in the governance process are made as accountable as possible. If this is done then there is the possibility that the interests of the managers and the interests of the shareholders will align.

Much has been said in agency theory about the shareholder-manager relationship, but in focusing overly on this relationship it has been argued, adroitly it is submitted, that agency theory has ignored the fact that boards can act opportunistically (Raelin and Bondy 2013) and so accountability is needed to ensure the board and individual directors who constitute the board act properly. Boards will be accountable to the shareholders (and/or supervisory boards in two-tier systems), just as the managers are accountable to boards on the basis that the latter act on behalf of the shareholders.

Agency theory has been subject to substantial criticism (Donaldson 1990; Heath 2009; Clarke 2014; Schillemans and Basuic 2015; Lambright 2009) with some limiting its application to

situations where the relevant parties to an agency relationship are at odds (Davis et al 1997a), and many others questioning the moral implications of the agency theory. A significant number of commentators have been dismissive of the theory's underlying assumption about human nature (Donaldson 1990; Bergen et al 1992; Lambright 2009), because the theory overly simplifies the way that humans operate on the basis that self-dealing does not adequately explain the complexity of human actions (Davis et al 1997a). Hendry has said that : "boards are not simply arenas of self-seeking as economic theory tends to assume, and the problems they face are not restricted to the control problem of standard agency theory. The world is more complex than that..." (2005, S56)

Another prime criticism of the theory is that, from a legal perspective, there is in fact no agency relationship in a corporate setting. In the seminal case of *Salomon v Salomon and Co Ltd*<sup>2</sup> which held that the company is a legal person that is separate from the shareholders, even when, as in this case, one person essentially controlled it and held most of the shares in it, Lord Herschell stated :

"In a popular sense, a company may in every case be said to carry on business for and on behalf of its shareholders; but this certainly does not in point of law constitute the relation of principal and agent between them" (43).

#### **4. Stewardship Theory**

Stewardship theory is presented as an alternative (some might say "complementary") to agency theory. Unlike agency theory which focuses on control and conflict, stewardship theory emphasises co-operation and collaboration (Sundaramuthy and Lewis 2003), and provides a non-economic premise for explaining relationships. It is a theory that has been credited to organisational behaviour scholars in the past 20-25 years, but it has been expressed and practised in different forms for much longer than that. Certainly, Dodd, in his writings of the 1930s and in his famous public debates with Berle, posited some views that can be seen as similar to, or consistent with, stewardship theory. During the period from the 1920s to the early 1970s directors in the US and the UK, while practising what is generally known as "managerialism," widely regarded themselves as stewards (Stout 2013) and acted in line with a broad stewardship approach.

The stewardship theory holds, essentially, that directors act as stewards and will not be concerned about fostering their own economic interests, as agency theory holds, but will be willing to act in the best interests of their company, and they will act in a way that leads to collectivist/organisational utility rather than self-serving benefits. In working towards organisational ends the personal needs of directors are fulfilled (Sundaramuthy and Lewis 2003; Kluevers and Tippett 2011). Thus, directors acting as stewards are concerned about acting honourably and "doing the right thing" (Stout 2003,8). Stewardship theory is marked by the idea of service for others and not self-interest (Block 1993). Some commentators go further and say that the theory "assumes a commitment to the welfare, growth and wholeness of others..." (Caldwell and Karri 2005, 255).

Stewardship theory puts forward the view that individuals, and this includes directors, can often be motivated by considerations of fairness, justice and concern for the interests of others (Buchanan 1996), and directors often see themselves as stewards of the company's

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<sup>2</sup> [1897] AC 22.

affairs who can be trusted to do a good, professional job, and they are so connected to the aims of the company that that these take precedence over their self-interest (Hernandez 2012; Schillemans and Basuioac 2015). As professionals they will make some degree of personal sacrifice and act honestly and diligently and this is not to be seen as quirky behaviour (Blair and Stout, 2001a). They seek intrinsic rewards such as reciprocity and take satisfaction in seeing organisational success, rather than, as classically portrayed, endeavouring to obtain extrinsic rewards, which are primarily of an economic nature (Davis et al 1997a; Pastoriza and Arinio 2008; Tosi et al 2003). This type of approach to management can be seen in practice in many Japanese companies where the managers are very loyal to their companies and place great emphasis on the interests of their companies (Martynov 2009). Blair and Stout (2001a) argue from their survey of the empirical work of many social scientists that trustworthy conduct occurs and this is not unpredictable.

Like agency theory, stewardship theory emphasises the need for the alignment of the aims of the principal and the agent (Arthurs 2003), but unlike agency theory, stewardship theory assumes that boards and managers are stewards whose behavior is aligned automatically, on appointment, with the objectives of their principals (Davis et al 1997a; Pastoriza and Arinio 2008). The theory maintains that directors have a different form of motivation from that posited by agency theory, one that is drawn from organisational theory and based on studies in both psychology and sociology. Under stewardship theory directors are viewed as loyal to the company. While agency theory posits individualism, stewardship theory adheres to collectivism. Hernandez has defined the theory succinctly in the following manner : “[T]he extent to which an individual willingly subjugates his or her personal interests to act in protection of others’ long-term welfare.” (2012, 174)

With this theory, the dominant motive, which directs board members to accomplish their job, is their desire to perform excellently and with honour. Specifically, directors are conceived as being motivated by a need to achieve, to gain intrinsic satisfaction through achievement, self-actualisation and a chance to grow (Davis et al 1997a), and more specifically successfully performing inherently challenging work, to exercise responsibility and authority, and thereby to gain recognition from peers and bosses. Therefore, there are non-financial motivations for directors acting as stewards. It means that the central element of the theory is trust (Davis et al 2001a; Bundt 2000; Hernandez, 2007; Huse 2007; Barclift 2007; Kluvers and Tippett 2011). That, together with collective goals and relational reciprocity, leads to the development of long-term relationships which is beneficial to all concerned, and as a result directors can be trusted (Kluvers and Tippett 2011). But directors clearly have a personal interest in acting as stewards. Unlike agency theory, which sees a need to bring the managers’ interests into alignment with those of the principals, stewardship theory perceives the interests of the managers as being already aligned with those of the principals (Pastoriza and Arinio 2008). The theory emphasizes goal convergence (Van Slyke 2006) rather than conflict as posited by agency theory. Stewardship theory also holds that an organisation requires a structure that allows harmonisation to be achieved most efficiently between directors and shareholders. Thus it might be thought that issues of “motivation, goal congruence, trust and organizational identification have been captured in the stewardship theory of management.” (Van Puyvelde et al 2013: 65)

While the theory might not have the same lineage as agency theory, it has sought to be employed in conducting a wide amount of research and in relation to a number of issues and topics. A drawback with stewardship theory might be seen to be the fact that a greater transaction cost outlay will be made as there will be more investment of time for the principal



in involving the steward in resolving problems, joint decision-making and information exchange (Van Slyke 2006). Like agency theory it has been subject to criticism.<sup>3</sup> The theory is sometimes criticised on the basis that it gives directors carte blanche when it comes to exercising their discretion, but it must be acknowledged that boards are constrained by a number of factors such as the availability of an appropriate workforce, the demand for the products of the company and the cost and availability of finance (Blair and Stout 2001a).

## 5. The relevance of accountability in relation to stewardship theory

Given the nature of stewardship theory, does it not mean that accountability is otiose if board members are acting as stewards? Is it counter-intuitive to have accountability mechanisms where directors are acting as stewards? Is it possible to say that it is only necessary where agency theory is applied because there are concerns over the intentions of the directors? Is it such that any mechanisms introduced to facilitate accountability could “crowd out intrinsic motivation” (Schillemans and Basuic 2015, 209) and perhaps even destroy trust that is presupposed in stewardship theory? (Broadbent et al 1996). Davis, Schoorman and Donaldson (1997b), argue that mechanisms of monitoring and bonding are not needed because under stewardship theory there is no need to prevent agency losses. But, they do not say that accountability mechanisms which are different from monitoring and bonding, are redundant. While stewardship theory focuses on structures that empower rather than control (Davis et al 1997a), it is submitted here that it is still necessary for boards to account.

Generally speaking it is contended here that accountability and its aims in relation to a company's board are regarded too narrowly in the literature. Accountability has greater relevance and has a broader ambit than simply addressing potential agency problems. It is also more expansive than involving a control function, as it is so often perceived (Romzek and Dubnick 1987) by commentators who have linked accountability to control.

It is argued that there are in fact a variety of reasons why board accountability is necessary and appropriate even under stewardship theory in a corporate setting, although it might be the case that different mechanisms might be used when compared to those employed to address agency problems. For instance, internal accountability mechanisms (Dicke 2002) might be more appropriate for those acting as stewards. The following identifies and explains the reasons why accountability is as important under stewardship theory as under agency theory.

### 5.1 Legitimacy : The primary rationale for the accountability of boards

All bodies need to be regarded as legitimate. The board of directors is no different. In fact given its position and role the need for legitimacy is critical. Typically, today, either legislation or the company's articles of association/ by-laws will vest the board of directors with very broad general management powers, many of which are then delegated to company managers and officers. In some jurisdictions, such as the UK and Australia, where directors have been given wide-ranging powers, they alone can exercise them, and the only action that the members can take is to pass a special resolution to amend the articles/by-laws; the shareholders cannot interfere in the exercise of the management power except in very limited circumstances.<sup>4</sup> Sharfman actually refers to the very wide powers of the board granted by

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<sup>3</sup> For instance, see Tricker.

<sup>4</sup> John Shaw & Sons (Salford) Ltd v Shaw (1935) 2 KB 113; Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame) (1906) 2 Ch 34.

legislation in the US as “staggering” (2012, 904). Corporate law effectively centralises power and authority in the board of directors and provides for a centralised structure that controls the company; corporate law provides the board with exclusive authority and power to manage the affairs of the company.

In the corporate context if there is no accountability as far as the board is concerned then some stakeholders, at least, are likely to be suspicious of the board. There is not likely to be absolute trust in the directors amongst all shareholders of the company, and the depth of trust will vary. The board needs to acquire credibility. In this regard accountability goes some way to providing boards with that credibility. It grants them, in effect, a licence to operate and it is an avenue to enable trust to be built up as well as credibility and reputation (Schillemans and Basuic 2015). O’Neill (2002) argues that well-placed trust only develops from inquiry, and inquiry is an essential element of the accounting process. In giving an account that is found to be truthful there is an enhancement of trust. The end result can be that directors are able to expand their autonomy with the support of the shareholders and other stakeholders. If there is accountability then the board will be regarded as legitimately holding power and be able to continue to employ that power with the express or implicit acquiescence of the shareholders (Moore 2013; Keay 2015).

It might be argued that if there is a high level of trust in the board, on the basis of stewardship theory, there is not the same need for accountability as the board will be legitimated. While stewards focus on structures that empower rather than control, and there is probably less need for monitoring, it is still necessary for there to be some accounting. Conflicts are likely to occur, and shareholders need to be assured that their directors are acting appropriately. While stewardship theory holds that it cannot be assumed that relationships will be characterised by conflict, as agency theory does, it does not deny that it might exist at some point (Caers, et al 2006; Kluyers and Tippett 2011). Conflicts of interest that are a focal point for the agency theory can emerge from a number of different motives on the part of agents and principals (Buchanan 1996); it does not always have to be a matter of self-interest on the part of the directors as it could revolve around other issues such as arguments about strategy or financing. Thus accountability ensures a degree of comfort to the shareholders that conflicts are not harming the company. Also, while there still needs to be accountability, unlike with agency theory measures are aimed at appealing to the steward’s sense of responsibility and wanting to adhere to the same set of values as the other contracting parties, rather than other more base concerns, on which agency theory is sometimes contended to be founded.

## 5.2 Accountability can benefit directors

Board accountability is usually regarded as a process that is designed to benefit shareholders or even non-shareholding stakeholders. Accountability is often seen as a negative experience for the accountant, the one who gives an account (the directors in our case), and a process that only involves checking up on the accountant’s actions. So it is not seen as a “nice” style of governance and not pleasant to be the one who is on the end of it. But that is a flawed view of accountability because accounting can prove to be of mutual benefit as it is capable of being positive and providing an affirming experience for the directors, as well as providing comfort for the shareholders/stakeholders. Board members need to give an account in order to obtain feedback, recognition, approval, and understanding. All people want to feel good about themselves and what they do (Cooper and Johnston 2012), and one way for individuals to achieve this is to be accountable (Douglas 1994), in order to secure recognition and a feeling that they are contributing something in their professional lives. According to Roberts (1991):

“[T]o be held accountable for one’s actions serves to sharpen one’s sense of self and one’s actions. The practice of accountability focuses attention within the flow of experiencing; it acknowledges and confirms self, and the fact that one’s actions make a difference. Conversely in the absence of being held accountable there is the possibility of a weakening and blurring of one’s sense of self and situation... To be held accountable hence sharpens and clarifies our sense of self, and provides focus within the stream of experiencing” (356, 358)

Giving an account involves giving reasons for one’s conduct and makes one’s life intelligible and provides it with meaning (Schweiker 1993; Shearer 2002). Furthermore, directors are moral beings and as a consequence they should be accountable (Joannides 2012), for the actions of everyone will have consequences for others (Cooper and Johnston 2012). If directors are accountable then they are affirmed as moral beings. It is innate in humans to be accountable as we are account/reason-giving beings (Tilly 2004; Dubnik, 2007a; Staszewski 2009). Providing an account can lead to the accountant being regarded as a moral and responsible person (Shearer 2002) and that can evoke feelings of fidelity in the accountant (Dubnik 2007b). It can demonstrate to accountors that they can make a difference to others (Roberts 1991), and that should produce satisfaction in any accountant. In the process of accounting accountors learn of the attitudes of others (the accountees) towards the accountors and this can convey to the accountors confirmation that they crave (Roberts 1991). The process of being held accountable requires directors to recognise the fact that they might not have lived up to the required standards and they might have perpetrated some harm as a result of what they have done (Loughrey 2014; Solomon 2009).

We have seen that one of the stages of the accountability process is the possibility of consequences for the accountant. So often this is seen as a negative element, but that does not have to be the case for the accountees may provide praise to, and reward for, the accountant. An example of this could be a commendation from the company’s AGM in relation to the way that the board has handled a particular transaction or put in train an element of corporate strategy.

So, the response to accounting can be recognition of the accountors by the accountees and the formers’ worth which can be encouraging for accountors; without accounting there is no praise and no understanding of the fact that accountors’ activity makes a difference both to the accountees and to the accountors themselves (Roberts 1991). Accounting provides directors with the chance to shine. Any recognition of what the accountors have done is not permanent and so accounting has to be repeated (Roberts 1991). In the view of Roberts accounting is effective for accountors by way of offering them “a seemingly unavoidable, incontrovertible image” (1991, 359) of themselves and their activity.

Roberts (2001) also takes the view that shame/pride and conscience lead board members to the point where they have a need to be accountable for what they do. If directors do not act properly then they will be subject to fear of damaging their professional and personal reputations, which are important matters for directors as far as the market for labour is concerned. This is the market that will determine whether a director will get another/better post at a different company. All of this means that accountability is actually vital for board members as it keeps them sane and reminds them of their dependence on others and their own limitations as human beings, which all contributes to the fulfilment of social norms (Roberts 2001).

The process of accounting to accountees might well enable the accountant to see the implications and ramifications of their decisions and actions (IMF 1998), and so it enables the accountant to reflect, learn and develop as the accountant receives feedback from the accountee (Bovens 2010; Blagescu et al 2005). Without this accountants might be performing their duties in the wrong or in an inefficient way and that might ultimately affect their reputation or standing. Directors need to know, for instance, if there are issues with which they are not dealing and that they are basing strategy on wrong premises or that they are not achieving the right aim(s).

### 5.3 Stewardship is not likely to be the exclusive explanation of directorial behaviour

While some scholars see stewardship and agency theories as mutually exclusive (Schoorman et al 1997; Bundt 2000), others see the theories as complementary (Caers et al 2006; Dicke and Ott 2007; Van Puyvelde et al 2012), and the latter assert that the theories might be capable of integration (Davis et al 1997(b)). Also it is posited that neither of the two theories alone can provide a comprehensive model of the behaviour of directors (Martynov 2009); no theory is correct in all situations (Lee and O'Neill 2003). Stewardship theory can be viewed as circumscribing agency theory (Caers et al 2006), and also addressing many of the limitations of agency theory (Daily et al 2003), but it is not the approach that is able solely to explain the action of all directors all of the time. It has been asserted that it is oversimplifying matters to say that a director acts either as an agent (in the context of agency theory) or acts as a steward (Martynov 2009) as people act both selfishly and altruistically from time to time, often depending on the circumstances, and it will be difficult, if not impossible, to find someone who acts solely as a steward or acts solely as an agent (Nicholson and Kiel 2007; Pastoriza and Arinio 2008). While humans might act professionally and in a trustworthy manner for the greater part, or even most, of their professional lives, it does not mean that at some stage they will not act in a self-serving way. Most people are going to engage in self-seeking behaviour to some extent (Hendry 2002), even if it is not perceived as heinous behavior. This is particularly so if the principal is a self-maximiser (Kauppi and van Raaij 2015), or engages in such activity at some point.

What is difficult is ascertaining why a person is acting altruistically; it might be difficult sometimes to know whether directors do something because of professionalism or because some external incentive exists. Directors might be behaving to achieve egotistical goals on the one hand, or "other regarding" objectives on the other, the latter being seen as laudable while the former is not. Determining the reasons that a director does something is delving into the realms of human intent and motivation and what a person intends is difficult to discern at the best of times. While objective facts might shine light on what a person intended, usually only relevant actors will know what their purpose were when doing something. Also, while professionals might act opportunistically on occasions, it does not mean that their whole professional service is marked by self-serving behaviour. The behaviour of a lot of people is likely to be mixed and thus both agent and steward features are manifested in their professional lives (Martynov 2009). Experimental research in the psychological field indicates that "most people behave as if they have two personalities or preference functions. In some contexts they are competitive and behave selfishly. But when the social conditions are right, their co-operative, other-regarding personalities emerge" (Blair and Stout 2001b, 1742-43). How people act is determined not only by their own character, but often also by the social context. Thus, the atmosphere within a company, the hierarchical structure of an organisation and the culture within it can have an impact on the

way directors behave. Some environments or circumstances will trigger self-interested behaviour while others may arouse regard for other interests (Davis et al 1997a; Lubatkin 2005; Perrow 1986).

It is contended that a continuum exists with extreme agent and steward type behaviour existing at either ends of the continuum (Pastoriza and Arinio 2008; Martynov 2009), and most people are somewhere in-between the ends, exhibiting mixed behaviour. It is, therefore, necessary to have a multi-theoretic approach (Daily et al 2003), and this is consistent with the notion that “no theory is accurate in all contexts” (Lee and O’Neill 2003:213), something that is supported by empirical studies in relation to the behaviour of directors (Davis et al 1997a; Tosi et al 2003). Hence, it is possible for stewardship to operate alongside agency theory (Albanese et al 1997; Dicke and Ott 2007; Lambright 2009; Van Puyvelde et al 2012). This is supported by the fact that empirical studies have been mixed in their findings as to whether either agency theory or stewardship theory is the better way to explain management behaviour (Davis et al 1997a; Tosi et al 2003). In one study Lambright (2009) found that not all of the persons whom she interviewed were self-interested actors motivated by extrinsic benefits and nor were all motivated by intrinsic goals as posited by stewardship theory. Nicholson and Kiel (2007) ascertained in an empirical study that directors do exploit their positions and so stewardship theory could not explain some of their results. The directors that were participants in Lambright’s study exhibited both agent and steward values, thus placing them in the middle of the agency-stewardship continuum. A study undertaken by Schillemans led him to conclude that stewardship theory does not provide that agents who are stewards will always be motivated only by “pro-social goals.” (2013, 544) Allied to this is the fact that when hiring a director it cannot be known for sure whether he or she will act as a steward (Sundaramuthy and Lewis 2003), for it can be difficult to distinguish those who will act opportunistically and those that will not (Barney 1990), and so the company is taking a risk when hiring directors. The company is in a potentially vulnerable position because while the company might demonstrate trust in the director and that he or she will act as a steward, there is no guarantee that the director will do so.

The bottom line is that if directors might not always act as stewards, but at times they act as agents (Albanese et al 1997; Davis et al 1997b), then it seems to suggest that they should be accountable in order to ensure there is appropriate protection for the company.

#### 5.4 Accountability and competence

While directors who acts as stewards might be able to assure the company that they will not engage in the typical agency conduct of self-dealing or shirking, and the directors are true to their word and can be trusted as far as their loyalty is concerned, thus demonstrating good intentions, it does not mean that stewards will be competent in all things; perfect competence does not exist in the real world (Hendy, 2002). The steward could well be, at times, honestly incompetent (Hendry, 2002; Kauppi and van Raaij 2015), even when in the process of trying to maximise the wealth of the principal (Kauppi and van Raaij 2015) and acting selflessly. All humans have limitations, due to many reasons including bounded rationality, which involves acceptance of the fact that humans have limited knowledge and foresight. As a consequence well-intentioned directors can make mistakes (Kauppi and van Raaij 2015), or labour under misunderstandings, and some judgments made by directors can be wrong because, for instance, they are made when inadequately informed as information asymmetry does not merely affect principals (Dou et al; Kauppi and van Raaij 2015). Also, directors can fail to interpret correctly or be aware of the objectives which have been assigned to them

(Hendry, 2002), leading to a failure of goal congruence (Dou et al 2010). It is expected that there might be wrong decisions made simply because of the fact that they were made by fallible humans, and it is arguable that directors should be accountable for what they did and this will include confession of errors. In one empirical study it was established that problems that are often attributed to an agent's self-seeking attitude can actually emanate from the agent not being conversant with the objectives of the principal (Kauppi and van Raaij 2015). The researchers also found that the giving of feedback, which is part of the accountability process, can support goal congruence (Kauppi and van Raaij 2015), thus reducing the chances of directors not being conversant with the aims of the company.

Being accountable enables directors as accountors to reflect on what they have done and for the accountee, at the end of the accountability process, to put in place something that might assist the directors, such as ensuring directors have both the necessary information that they need and the required guidance to do their job properly (Kauppi and van Raaij 2015). Normally mechanisms that allow for accounting in this type of situation will differ from those that are established to deal with the archetypal agency problems (Hendry, 2002), for the aim is not to ensure directors' loyalty and effort, but to ensure that directors know what they should be doing and to correct any misconceptions. This will enable awareness of what sort of assistance, training or guidance directors need so that they can do their jobs well and efficiently. In the empirical study, just referred to, researchers found that guidance and training was able to assist in the diminution of information asymmetry on the part of the agent (Kauppi and van Raaij 2015).

Agency theory aims to address the provision of mechanisms designed to ensure that agents do not engage in self-dealing and shirking, but it does not cover the commission of errors of judgment and a director could prejudicially affect the running of a company more from incompetence than self-dealing (Martynov 2009), especially if the incompetence were to continue without some form of accounting and consequential correction and/or assistance being provided. Directors should not necessarily be liable for any errors of judgment as, *inter alia*, if they were it would deter people from becoming directors and could encourage directors not to account transparently. But there is no reason why directors should not be accountable for errors. Being held to account for errors does not necessarily mean that they should be held legally liable for them. Accountability is, as already suggested, a process that will enable the company to know what help or guidance might be needed by directors, as well as to ensure that the company can know that the directors are sufficiently able to do their jobs properly.

In relation to this issue, it might be argued that accountability is important so that the shareholders can determine how well the company has performed, and whether it could have performed even better. Ascertaining this will not necessarily lead to the censuring of the directors, but lead to a re-direction in relation to their duties and functions or the provision of more information and/or better assistance or guidance.

### 5.5 Accountability as an aid to communication and building relationships

Accountability can be regarded as a learning experience for the accountor, and how they can better respond to accountees' needs (Blagescu et al 2005), and the accountees can respond to accountors concerning what they have done in carrying out their responsibilities. It is important, as indicated earlier, that a company knows what its directors are doing, primarily so that the company can be assured that they are aware of, and working towards the

achievement of, the objectives of the company (Schillemans 2013), and the directors can ensure that what they are doing is consistent with the company's expectations. This in itself can give directors professional satisfaction.

The accounting process involves an important communication process that aids both parties. It is critical that the directors, even if acting as stewards, are on the same page as each other and the company. Stewardship theory accepts, as does agency theory, the existence of bounded rationality, which provides that there are limits to the human mind in comprehending and solving complex problems. Bounded rationality recognizes that it is impossible for humans to comprehend and analyse all of the potentially relevant information in making choices, and the accountability process can help the company to become aware of any lacunae in the directors' knowledge.

Besides being a communication experience, accountability is, as noted earlier, also a socialising process (Roberts, 2001) as it is a relational concept (Ebrahim 2005) that involves a discourse that reflects a social relation between the accountant and the accountee. It facilitates the building of a relationship between the board and the shareholders and is one based on respect. This can promote greater trust and greater efficiency, which should produce more benefits to those who are connected with the company.

#### 5.6 Accountability might forestall imposition of regulation

At various times governments consider regulating particular areas of commerce. In recent times regulatory measures, in the form of provisions of the Small Business, Enterprise and Employment Act 2015, have been passed by the UK Parliament to address the position of directors. One such provision is section 110 permitting courts that accede to applications for the disqualification of directors from acting as directors for a certain period of time to be able to order that the directors pay compensation to the company's creditors. This has been done partly because the government has maintained that directors have not been sufficiently accountable for what they have done. Yet governments might think that if there is sufficient accountability of directors, then there might not be any need for regulation. Certainly it is generally thought that regulation was withheld by the UK government in 1992 following the work of the Cadbury Committee, which was established in the wake of the Maxwell scandal and the collapse of several other large companies, such as Polly Peck, and at a time when there were clear failures of boards to be accountable. Cadbury was the catalyst for the development of the framework for modern corporate governance in the UK, including the development of a corporate governance code. The Report made it clear that voluntary policing of corporate governance by companies themselves and ensuring boards were subject to the monitoring of shareholders could constitute the remedial action that was needed in the corporate sector. Certainly the Report of the Greenbury Committee, which followed Cadbury, continued a focus on accountability and enhanced performance. The Greenbury Committee said that if this were done then there would be no need for outside regulation of companies (para 1.13).

#### 5.7 Accountability as a benefit for efficiency and decision-making

The existence of accountability mechanisms might incentivise thoughtful decision-making (Hurt 2013), which can then lead to improved corporate performance. Because boards have to account, then potentially the work of boards is going to be better and more efficient as it will help concentrate the collective mind of the board on what it has to do. The prospect of

accountability might have the effect of deterring the worst mistakes of directors and encourage more careful decision-making; it might just precipitate pause for thought before taking of action. The board might engage in more thorough monitoring and deliberation if it is known that an accounting has to occur. It might be regarded as “a tool to induce reflection and learning,” for boards so that they are effective in delivering on their promises and using their powers properly (Bovens 2010, 955-956). The fact is that in circumstances where a decision-maker like a board has to explain and justify its actions and conduct it is likely that its decisions and the manner in which it operates will be better than where there is an absence of checks (Moore 2013).

Accountability involves a process whereby the company’s shareholders are informed what the board has done and the latter’s actions can be corrected where necessary. Accountability has another role besides the ex post evaluation of actions that is often seen as the essential element of accountability. It can act as an ex ante measure and have a prophylactic effect. The process of accountability can enable boards both to look to the future and see matters that warrant further consideration and be aware of fresh approaches that can be employed which can make directors more effective. It is possible that the board does not have all of the information or skills needed in a particular situation so the shareholders could be used as a corrective mechanism (Arrow 1974) through the accountability process, and thereby produce greater efficiency. Even before evaluations are received from shareholders, the actions involved in the accountability process, such as disclosing material and preparing explanations and justifications, can bring issues to the directors’ attention and thus enable them to act more insightfully, efficiently and appropriately.

#### 5.8 Accountability prevents overly cosy relationships from being detrimental

Stewardship is a collaborative approach, and it is seen by some as leading to an enduring board-management relationship (Sundaramuthy and Lewis 2003). Arguably though, stewardship can create problems that stem from the fact that a board is a group. If there is a lack of accountability then these problems might not be identified and addressed. Forbes and Milliken describe boards as “elite and episodic decision-making groups” (1999, 492), and it seems that there is little doubt that boards are heavily dependent on social-psychological processes, and they can be greatly affected by them. These processes can be broken down into several factors. A primary one is structural bias.<sup>5</sup> This refers to the prejudice which board members may have in favour of colleagues and the cosy relationship that can exist within the board and amongst its members. The existence of structural bias has been accepted by some US judges (Velasco 2004). It can result from a natural empathy shared by directors towards one another (Cox 1982), and it is associated with the fact that professional and social relationships do develop quite naturally amongst directors and this can hinder independence when it comes to making decisions. Bias can emerge not, necessarily, because directors are seeking to benefit themselves and be disloyal to their companies. Those endeavouring to be good stewards can be overtaken by it and without realising that it is happening. After a reasonable period of time on a board it has been found that the members will progressively assume a feeling of what social psychologists refer to as “in-group” solidarity and this will affect how they deal with items of business (Langevoort 2001). In-group bias is the “tendency to evaluate one’s own group more positively in relation to other groups” (Healey and Romero 2000, 157) and this might lead to bestowing preferential treatment on group members or viewing opinions, in the context of a board, of executives and others benignly

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<sup>5</sup> For further and more detailed discussion of this, see Davis (2005); Velasco (2004); Page (2009).



(Page 2009). It has even been said that this action might be seen by members as natural as preferring one's own children (Rudman 2004).

A related factor that also involves in-group bias is groupthink. Suffice it to say groupthink, according to the research work of social psychologist, Irving Janis, is :

“a mode of thinking that people engage in when they are deeply involved in a cohesive in-group, when the members' striving for unanimity overrides their motivation to realistically appraise alternative courses of action.” (1972, 78).

Members of groups tend to fail to undertake critical reflection (Janis 1972), and the result of this approach is often that members will effectively censor themselves in that they will remain quiet notwithstanding some qualms about what is being proposed (Prendergast 1993), in case they “stick out like a sore thumb” (O'Connor 2003:1288) or be perceived as “rocking the boat.”

All of this might mean that directors refrain from questioning what has been done by those executive directors and managers who are well positioned in the company, and who have a good understanding of the company's business. But if the board members are accountable it is more likely that the cosy kind of relationships mentioned here might be avoided, at least to the point of not harming the company to the same extent that it would where adequate accountability was absent as members of the board will have to account for what it has done and so might be more ready and willing to challenge executives and their actions.

## **6. Directorial Reaction**

It might be argued that if directors who see themselves as stewards are made accountable, which involves a degree of control being exerted over them, they will feel that they are perceived as being untrustworthy (Davis et al 1997), and it will either dissuade them taking up office or cause them to resign. Of course, this is a possible reaction, but it is contended that the various reasons articulated above for requiring an accounting, even where directors are acting as stewards, are substantial and should not discourage a director who is earnestly seeking to achieve benefits for his or her company. Much is likely to turn on how the company evaluates what directors have done and what is the reaction of it and the shareholders to the directors' explanations. If the accounting process is undertaken in a spirit of respect and co-operation then it is submitted that it should not constitute a significant threat to the directors and the way that they operate. It is suggested that accountability as a process should not necessarily destroy feelings of trust. As pointed out earlier in the paper, well-placed trust only develops from inquiry, and inquiry is an essential element of the accounting process (O'Neill 2002).

The situation where a real problem is likely to emerge is if the company and its shareholders either take an agency theory approach to the relationship with the directors and indicate that they do not trust directors, or they proceed with the accountability process in a confrontational manner which suggests that they might feel that the directors are hiding something, thereby creating “an us and them” mentality.

## **7. In practice**

The process of accountability in relation to stewardship theory is likely to be very similar in many ways to that applicable where agency theory is applied. For instance, AGMs will be provided for and they would be critical aspects of the accountability process. Also, when thinking about the competence of directors the accountability process in stewardship theory is likely to be very similar to that in agency theory even though with the former there is not the same presumption that directors will shirk. Where a stewardship based accountability approach could differ is in the (or greater) employment of internal mechanisms that are built on trust and professionalism. These might be utilized more in stewardship theory as the directors are more likely to be expected to share about the work that they are doing, and many directors are likely to be prepared to do given their approach to management as these mechanisms might appeal to a director's sense of personal responsibility and they will appreciate the expectations of their company that is endeavouring to apply a stewardship approach (Dicke 2002). The kinds of mechanisms that are introduced could well depend on the nature and business of the company, as well as the roles of individual directors, but it might involve something like peer reviews which could benefit the directors as much as the company and also the use of focus groups where directors individually or collectively address shareholders and those holding key stakeholder interests on what the board has decided to do and why they have done so. As indicated earlier, the concern is to ensure that the company understands what strategy is being implemented and why it. The meetings just adverted to would provide directors with the opportunity to demonstrate their commitment to the company and their professionalism and on the other side of the coin it would enable shareholders and stakeholders to ascertain the approach of the directors to managing the company.

In jurisdictions in which the two tier board system is used and where the management board is accountable to the supervisory board, it might also be beneficial for the management board to be required, besides meeting with the supervisory board, to meet with stakeholder groups or representatives of such groups in order to explain their actions, as the supervisory board tends to be limited to representing the shareholders and employees. This opportunity would permit the management board to be able to address head on issues that concern stakeholders.

What accountability processes are put in place and how they are administered can hinge on the issue of to whom the directors are accountable. This is a significant issue and cannot be examined here.<sup>6</sup> Agency theory holds that the directors are accountable to the shareholders. Whereas stewardship theory is not so constrained. In Anglo-American systems the approach generally is that accountability is owed to the shareholders, but this is not the case elsewhere (or in some countries that generally apply the Anglo-American system, such as South Africa). If accountability is owed to stakeholders then the accountability process could involve directors being asked to address meetings of stakeholders as well as shareholders to report on what the board has done. It would be appropriate for derivative actions, which allow someone other than the company itself to take action against miscreant directors, to be made available also to non-shareholding stakeholders so that, if necessary, the enforcement element of accountability can be effective. Legislation might provide that any party with an interest in the company could be entitled to bring derivative proceedings against directors (Keay, 2011). An application would have to be subject to court scrutiny in the early stages of the proceedings to determine whether the applicant is in fact a party who has an interest in the

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<sup>6</sup> See, Keay (2015).

company. Canada, Singapore and South Africa all have mechanisms allowing for stakeholders to initiate proceedings.

In some jurisdictions directors have to report on how they have addressed certain issues. For instance, in the UK the directors are required, in something known as a Strategic Report,<sup>7</sup> to include, inter alia, analysis using financial key performance indicators. It would be expected that such reports would be opportunities for the directors in stewardship theory to explain their actions in depth and demonstrate their professionalism as well as to enhance openness. At AGMs it would be expected that shareholders would be able to question the directors about such reviews, and in jurisdictions where directors are accountable to stakeholders then stakeholders would also have the opportunity to put questions to the directors either in AGMs or stakeholder meetings.

## 8. Conclusion

The rationale for board accountability, which is seen widely as a critical issue in corporate governance, is often said to be because of agency problems, and particularly on the basis that if directors are not accountable they might shirk or act opportunistically. Agency theory sees directors as agents who will act as self-maximisers rather than being concerned for the interests of their company and its shareholders/stakeholders.

Another theory, stewardship theory, which also seeks to conceptualise the role of directors might be thought to rule out any need for accountability as it is based on trust and reliance on the professionalism of directors. But this paper has argued that even if stewardship theory can be said to explain the behaviour of directors there is a need for board accountability. This is due to several reasons that are discussed in the paper. These reasons are partly based on the fact that directors are humans and flawed, but not predicated on one of the primary underlying principles behind agency theory that humans will act selfishly as a matter of course. Importantly, while there still needs to be accountability, unlike with what is advocated under agency theory, measures should be aimed at appealing to the director/steward's sense of responsibility and his or her desire to adhere to the same set of values as their company and its shareholders, rather than other more base ones, such as fulfilling self-interest.<sup>8</sup> The accountability process is often regarded in a negative light, particularly by boards, but it must be portrayed as a potentially positive experience as it is a mechanism that involves directors explaining what they have been doing and can in fact enrich them in the roles that they play.

It must be said that if we do accept that accountability is appropriate, even if stewardship theory can be said to represent board behaviour, it is important that careful thought needs to be given to what mechanisms are employed. Only those mechanisms that are appropriate and focused should be established and it is essential that they are used sensitively, thus countering any fear that accountability is necessarily a negative process and so as to ensure that directors do not feel that they are not trusted and valued.

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<sup>7</sup> Companies Act 2006, section 414A.

<sup>8</sup> Internal accountability can cover professional licensing, codes of ethics and peer reviews : Dicke 2002.

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