THE FOUNDATIONS OF GOVERNANCE THEORY: A CASE FOR THE RESOURCE-DEPENDENCE PERSPECTIVE

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Abstract

In this paper I distinguish between the justificatory and explanatory roles of theory, and propose that the justificatory role played in the literature thus far by agency theory is subject to limitations. I therefore argue for the use of resource-dependence theory as the epistemological basis of the corporate governance domain knowledge system, and present an alternate model of corporate governance. Potential contributions of this alternate model are discussed.

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1. INTRODUCTION

Despite the proliferation of multiple theories of corporate governance, including the resource-dependence, stakeholder and institutional theories, the epistemological basis of this domain remains the agency theory. As a result, research results are inconclusive, sometimes contradictory, on the question of what constitute best practices and desirable characteristics of firm corporate governance. For example, the series of meta-analytical reviews by Dalton and colleagues (Dalton et al., 1998; 1999; 2003) showcases the lack of consensus on the effects of key elements of corporate governance, including board size, board composition, and ownership structure.

The fundamental assertion of this paper is that the lack of consensus can be attributed, in some part, to the paucity of epistemological approaches other than those based on agency theory. Reliance on uni-theoretical approaches may not provide an adequate reflection of governance processes and practices in the business world, since such approaches do not consider the multiple motives which underlie firm participation in governance processes. Agency-based approaches dominate both theoretical and empirical inquiry, to the extent that investigation of other theoretical postulates also tends to rely on agency-based measures and methods. As a result, such investigations may lead to inconclusive evidence, and the potential contribution of other theoretical approaches to the domain is likely to be somewhat restricted. To overcome this limitation requires a discussion of the philosophical underpinnings of the corporate governance domain, particularly with a view to understand the overall epistemological system of this domain, and its various theoretical components.
To this end, I distinguish between the justificatory and explanatory roles of theory, and suggest that the justificatory role played thus far by agency theory may well be responsible for some of the empirical contradictions observed in the research. The use of alternate theories in a justificatory role, as opposed to explanatory roles, may serve to reconcile some of the contradictory findings in the literature, and pave the way for a more intensive understanding of corporate governance phenomena. Therefore, in this paper I explore the question of whether an alternate model of corporate governance is more appropriate. Specifically, I propose that resource-dependence theory offers a strong basis for the epistemological system of corporate governance, as opposed to the use of such theory to explain specific inter-relations between constructs.

2. CORPORATE GOVERNANCE: A SCHEMA

The domain of corporate governance has largely been influenced by the agency theory, though institutional (e.g. Shleifer and Vishny, 1997), resource-dependence (e.g. Hillman and Dalziel, 2003; Pfeffer, 1972) and stakeholder perspectives (e.g. Donaldson and Preston, 1995; Hillman and Keim, 2001), have been involved to explain various governance phenomena. Yet, the role of agency theory in the domain of corporate governance, relative to the roles of other theories of equal persuasion, is distinct. To examine this assertion of relativity, I first examine the role or function of a theory.

In general, theories may explain the context, or the broad conditions and contingencies under which certain phenomena appear. Such theories also generally identify the elements, such as actors, structures, and properties that can be found in such a knowledge system; broadly, the nature of concepts and constructs within that system, and the rules that form the boundary
conditions, thereby leading to normative outcomes (Buchanan Jr., 1986). Theories may also explain processes or relationships that occur between either the embedded constructs, or more often, the observable elements representative of those constructs within such a system. Theory can therefore be used either as a foundational basis that justifies the origins of an epistemological system, or as a lens or tool by which relationships between constructs embedded within the system can be examined and explained. In the former case, theory provides what can be called justificatory logic, or, arguments that support the conceptualization of the subject or domain space in a particular manner, including its principles (Brennan, 2006); whereas in the latter, it is the source of explanatory logic, which explicates relationships between elements. These concepts are illustrated in Figure 1.

This general framework can be applied to uni-theoretical systems, that is, systems where the justificatory and explanatory theories are the same, or to multi-theoretical systems, where more than one theory is used to explain relationships between variables. In the case of the latter, the applicability of one theory and not another to a relationship between elements may be determined by contingency conditions, which arise from basic rules in the knowledge system. That is, the rules in the underlying knowledge system determine the conditions under which a relationship between elements takes a particular form, which can then be explained by invoking the appropriate theory. The configurations of elements involving both the base knowledge system founded on justificatory logic, as well as the explanations for phenomena and relationships between constructs in the system, together constitute a schema or model. Justificatory and explanatory logics inform different layers of this schema.
The distinction between the use of a theory to generate the knowledge system, and the use of a theory to provide explanations for relationships linking elements within the system is important, because a change in the former signifies that the nature of the relationship between constructs is altered, whereas a change in the latter only affords a different explanation for what remains the same phenomenon. That is, justificatory logic is the source of a body of constructs and relationships, given a basic scientific principle. This basic principle can be derived through scientific processes that may take either a positivist approach, which views theoretical models as a representation of real phenomena; or a constructivist approach, wherein the focus of inquiry is the link between subjectively-constructed theoretical models and real world phenomena. Our interest, however, is not in the philosophical foundations of the scientific process, but more so, in the specifics of its application. A change in the justificatory logic used to form the domain knowledge system would affect the rules governing constructs within the system, leading potentially to a different set of normative conditions, since such logic is not neutral to the outcome (D’Agostino, 1996). However, a change in explanatory logic presumes that normative conditions remain the same, but the reason why certain relationships under those conditions are or are not evidenced is different. This is elaborated upon in Table 1. Changing the justificatory logic for a knowledge system can provide innovative solutions to issues in the domain by supporting the development of alternative models, since the implications go beyond the use of a different theory to explain relationships.

Predominantly, agency theory has informed the context, or base knowledge system of corporate governance itself, while other theories tend to offer explanations for relationships between various elements within this system. Particularly, resource-dependence and institutional theories inform a significant body of research. Yet, these theories are viewed as explanations,
which remain embedded in a context that is largely still defined by agency theory. Given agency theory as the source of the governance knowledge system, the key rule in this system would be that the separation of management and ownership gives rise to certain problems, the solution of which forms the crux of corporate governance. Managers, directors, owners, and other stakeholders can be identified as some of the actors in the system, and certain properties, for example, board size and ownership concentration, can be associated with them. Agency theory also provides explanatory inputs for the relationship between constructs within this system.

2.1. Justificatory and Explanatory Uses of Theory: An Example

Take, for instance, the issue of board composition, particularly, board diversity, broadly defined: The argument concerning the construct board diversity could draw from agency theory, to suggest that a more diverse board allows for a greater variety of inputs, which can result in better monitoring (Erhardt et al., 2003). At the same time, it is also possible to argue that the diversity of the board fosters innovative thinking (Watson et al., 1993), thereby enhancing the strategic value of the board (Bantel, 1993) and reducing the possibility of entrenchment of management ideas. It is also possible that a diverse board will hold greater legitimacy since such a board is a potential source of social capital (van der Walt and Ingley, 2003), and it is perceived that such a board may better represent shareholder interests. While the latter two explanations are derived from resource-dependence and institutional theory respectively, the underlying rule of the agency-based knowledge system still guides inference: the role of governance is to ameliorate the concerns arising from separation of ownership and control, and the relationship between board diversity and board efficacy is understood largely in the light of this premise, since agency theory underlies the notion of board efficacy. That is, constructs and elements in
the knowledge system derive their meaning from it. While other theories can explain how board diversity affects board efficacy, the notion of efficacy itself is embedded in a knowledge system generated using the agency theory.

What this paper argues for is the formulation of a model of corporate governance such that the tenets of the dominant agency theory can still be used to explain relationships between constructs; however, the knowledge system itself is generated using another theory relevant to the domain of corporate governance. The limitations inherent in the agency theory support this call for a re-schematization of corporate governance.

2.2. Agency Theory and its Limitations

The origins of the domain of corporate governance are typically traced to the classical work of Berle and Means (1932), in which the authors emphasize that while the ownership of capital is dispersed, control is concentrated in the hands of managers. Jensen (1986) and Jensen and Meckling (1976) formalized the issue by identifying the “agency costs” of such separation of ownership and control. While shareholders would prefer to maximize their profits, managers may invest the free cash flow at a return below the cost of capital, or use it inefficiently, in order to increase their control and power. The existence of agency also leads a “risk differential” (Jensen and Meckling, 1976). Since principals can own shares in more than one company this makes them less risk averse than managers, leading to differences in strategic aim and intent between the two groups. These conflicts lead to inefficiencies in firm functioning, and also give rise to costs associated with effecting mechanisms, such as monitoring, to curtail potential moral hazards.
Agency theory essentially suggests that the reduction of agency costs and inefficiencies in the functioning of the firm are likely to benefit the firm, given that these are directly linked to the risks, and returns, associated with the investment. While undoubtedly this is so, it also supposes a limited view of firm functioning, and of the relevance of corporate governance to the firm. Despite shifts in our understanding of what determines firm performance from the industrial organization (I/O) perspective to the resource-based view (RBV) (Barney, 1991), the validating logic, or raison d’être of corporate governance remains the agency theory. In terms of broader traditions, the former perspective places lesser emphasis on firm-specific competencies as affecting the ultimate outcome of profitability, as compared to the latter. The role of corporate governance, in such a context is ensuring that the profits generated are effectively protected and distributed, such that investors get a fair return. As proposed by Shleifer and Vishny (1997, at p. 737): “Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment.” Hence, agency theory emphasizes the distribution of profits, rather than the generation of profits. In this way, it is better associated with a strategic tradition such as the I/O perspective.

Compare this with the RBV, where the role of the firm, and its unique competencies, is critical to competitive advantage. In such a tradition, the focus is often on how firms can generate and exploit unique resources. Inspired by the notion that firm heterogeneity is the foundation of competitive advantage, scholars now address the question of whether, and how, corporate governance can contribute to this process (Barney et al., 2001). The role of corporate governance thus may go beyond protecting or distributing profits, to involve also the generation and allocation of resources, towards gaining competitive advantage.
Consequently, an agency-theory based knowledge system of corporate governance, while accounting for possible benefits arising from the governance-resources linkage, forms but one part of the validating logic of corporate governance, to accommodate what is accepted as the notion of corporate governance today, namely, “the determination of the broad uses to which organizational resources will be deployed and the resolution of conflicts among the myriad participants in organizations” (Daily et al., 2003: 371). A related, though more practice-oriented definition is suggested by Sir Adrian Cadbury (2000), who identifies the function of corporate governance as “to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources”. These definitions allows for agency theory explanations, on grounds that ‘broad uses’ covers decisions such as re-investment and declaration of dividends, and ‘conflicts’ refers to the quintessential divide between owners and managers. However, it is possible to read far more into contemporary views of corporate governance such as this, and thereby go beyond agency theory. For example, ‘conflicts’ could, in today’s context, as likely refer to stakeholder prioritization issues, or, even more generally, to best way use of corporate governance in the process of competition. Thus, agency theory, while still explaining many aspects of corporate governance, is less persuasive now as a complete and comprehensive view of the domain. Especially, given the wide acceptance that corporate governance is related to the competition for scarce resources (Palepu et al., 2002), the agency theory contributes little to understanding this new role of corporate governance.

2.3. Resource-Dependence Theory: The Basis of an Alternate Model

While undoubtedly the agency theory remains relevant to corporate governance research, I suggest that its value lies in explaining relationships between constructs in the governance
schema, but that these governance phenomena that are largely embedded in another theoretical context. This alternate context better relates to a broader tradition based on the view that competitive advantage fundamentally arises from firm heterogeneity. This recasts the potential role of corporate governance, from the distribution of resources, such that providers of capital are protected; to using corporate governance as a means to generate or enhance access to resources. Given this emphasis on firm competitive advantage, I present the resource-dependence theory as a likely candidate to form the basis of a governance knowledge system.

The resource-dependence view of corporate governance stems from the fundamental logic that various elements of corporate governance can act as critical resources for a firm. While based on the more general form of the resource-dependence theory (Pfeffer and Salancik, 1978), in the context of corporate governance, this theory can be applied to suggest that firm corporate governance can lead to generation of resources. Particularly, boards of directors contribute to a firm through their expertise and their linkages to other firms and institutions. Directors can also contribute to the positive valuation of a firm, through their reputation. Boards of directors can be a key source of various resources (Pfeffer, 1972), based on human capital and social capital (Certo, 2003). The former includes the directors’ advice and expertise, and the latter covers resources such as legitimacy (Westphal and Zajac, 1994) and links to other organizations. Cumulatively, these are all described as board capital (Hillman and Dalziel, 2003). The relationship between board capital and firm performance is well documented (Dalton et al., 1999; Pfeffer, 1972), thereby making the resource-dependence view a key theory in corporate governance.

Recent research, however, has extended Pfeffer and Salancik’s (1978) suggestion that having prestigious individuals on the board is a signal of “the value and worth of the
organization” (1978: 145), in two directions. The first of these still revolves mainly around the board of directors, but nevertheless, showcases many innovative contributions. Scholars have sought to attribute other functions to the board of directors, and expand the various resources and outcomes associated with directors. For example, the board has been viewed as a tool to manage environmental uncertainty (Boyd, 1990), and as a network mechanism to aid firm decision-making (Carpenter and Westphal, 2001). In this way, boards of directors are not only resources in themselves, but also serve as means to access other resources, sometimes to the exclusion of competitors. Board interlocks, for example, make it easier for firms to access various external resources, including information, or capital (Borgatti and Foster, 2003; Fischer and Pollock, 2004).

The second direction, in which the original view has been extended, looks towards the resource-related functions of other governance mechanisms. In this way, scholarly thought has expanded beyond Pfeffer and Salancik’s (1978) focus on directors. For example, it has been shown that in the course of their jobs, CEOs develop an array of specific knowledge (Harris and Helfat, 1997). This knowledge can be treated as human capital. Prestigious CEOs also increase the firm’s legitimacy, and provide links to other prestigious individuals (Daily and Johnson, 1997). Resource-dependence theory may also be relevant to explain the governance effects of owner-managers in entrepreneurial firms (Daily et al., 2002), as well as to explain potential benefits arising from different types of ownership; particularly, ownership by government authorities and large institutions. In general, therefore, the resource-dependence theory supports the view that corporate governance can be a means to acquire, generate, or maintain resources which result in competitive advantage for the firm.
The notion that multiple theories may be relevant to the domain is not a new one, and instances of such multi-theoretical work are increasingly on the rise (e.g. Hillman and Dalziel, 2003; Peng, 2004). The novel contribution herein is to examine the relative roles of these theories in the larger schema of corporate governance. Currently, research in this domain seems dominated by a schema of corporate governance where agency theory offers justification for the concept of corporate governance, thereby acting as the base of the governance knowledge system. Within this system resource-dependence theory, along with stakeholder, institutional, and again, agency theory, offers explanations for the phenomena, or inter-relationships between various constructs. The aim of this paper is to construct an alternative schema, where essentially, the roles of agency and resource-dependence theories are reversed. That is, I examine the notion that resource-dependence theory forms the basis of the governance knowledge system, and agency theory offers explanation for phenomena and inter-relationships between constructs within this system.

2.4. The Role of Institutional and Stakeholder Theories

At this point, a justification becomes necessary: Why do institutional and stakeholder theories not present themselves as frontrunners to form the epistemological basis of the governance domain? Or rather, why do we promote the candidature of resource-dependence theory, over the former two theories? The reasons for this are two-fold: First, both institutional and stakeholder theories, while proposing alternate explanations for governance outcomes, draw on the basics of agency theory to present arguments for why institutional and stakeholder influences can affect firm corporate governance. In this sense, agency theory is the justificatory theory, with which the explanatory institutional and stakeholder theories are in tandem. Second,
resource-dependence theory is able to account for the effects of institutions, stakeholders, and also for the basic premise of agency theory itself. Consequently, I conclude that it is the most comprehensive of the four.

Essentially, the knowledge system of a domain, being the source of normative rules for the domain, goes to the fundamental question of ‘why?’ in this particular case, ‘why corporate governance?’ Any theoretical view that is advanced as an alternative to the dominant agency view must essentially provide a novel rationale for the persistence and importance of the domain. Institutional theory, while valuable in its own right, does not however present such a novel rationalization, but rather suggests conditions under which the dominant agency theory might be applicable in different ways. That is, the purpose of corporate governance, under the institutional theory, remains resolution of the agency divide, though this perspective provides the additional insight that compliance with regulatory and normative institutional influences to so resolve the agency issue can bring benefits to the firm, particularly in terms of legitimacy and stability (Hart and Milstein, 2003; Suchman, 1995).

Similar is the case with stakeholder theory. Researchers have argued that the principles of shareholder-value maximization and the postulates of stakeholder theory are not necessarily at cross purposes (Sundaram and Inkpen, 2004). While these theories differ in terms of the primacy given to various constituents, the premise they share is that the role of governance is to minimize agency costs, and ensure that the primary constituent(s) interests are met. Therefore, despite the variations on the applicability of the agency postulate, the knowledge system remains largely the same across agency, stakeholder, and institutional theories. For these reasons, I propose that the resource-dependence theory has the most to offer in terms of a novel epistemological source of domain knowledge.
In this sense, resource-dependence theory is the most comprehensive in its coverage. Resource-dependence allows for stakeholder interests to be captured, by treating various stakeholder groups as sources of legitimacy, and other resources, including capital. Various stakeholders, including industry participants and customers are thus able to influence firms (Christmann, 2004). Consider then the findings that better stakeholder management positively affects firm performance (Donaldson and Preston, 1995; Hillman and Keim, 2001). This phenomenon can be explained as follows: Stakeholders potentially supply vital resources to the firm. Managing their interests effectively results in rewards to the firm, in the form of enhanced access to these resources. Different stakeholders are likely to control or supply different resources. Of these three statements, the first statement is based in resource-dependence theory, used in a justificatory role. The latter two statements use stakeholder theory in an explanatory role, to elaborate on how the phenomenon occurs as it does, that is, they explain relationships.

Resource-dependence theory similarly accounts for institutional influences, since in both regulatory and normative forms, various institutions can control access to resources, and sometimes award such access preferentially. Firms are rewarded for compliance with institutional influences (Oliver, 1991), and in the governance context, such influences include country legal environments (La Porta et al., 1998), as well as more normative forces such as ownership pressures (La Porta et al., 1999). More coercive institutional forces, such as law and regulation can impose punitive costs, or even prohibit access to resources, in the event of non-compliance. Institutional theory, therefore, can serve to elaborate on the influences that firms face, and also explain firms’ responses.

In the same way, it becomes possible to look at agency explanations using resource-dependence theory as a justificatory basis. As a very preliminary example, consider the basic
agency argument that better corporate governance enhances firm performance (Black et al., 2006; Durnev and Kim, 2005), since it serves to reduce investment risk by addressing agency concerns, and thus also reduces the cost of capital (Stulz, 1996; 1998), and other resources (Fiss and Zajac, 2004). It is possible to therefore, to locate this argument in the justificatory context of resource-dependence theory, with agency theory used as an explanatory tool. The basic notion is that of corporate governance aiding competitive advantage, by providing the firm with differential access to capital, as compared to competitors. This fundamental proposition is housed in resource-dependence theory. The explanation for this phenomenon however, is drawn from agency theory, whereby it is argued that reducing agency concerns is one of the ways in which corporate governance is so used, to gain such differential access to capital.

3. AN ALTERNATE MODEL OF CORPORATE GOVERNANCE

Having made a case for the construction of an alternate model of corporate governance based on the resource-dependence theory, I now proceed to develop this model through a process of comparison with the dominant agency-based model of corporate governance. This comparison is also presented in Table 2.

Insert Table 2 about here

As is conceptualized, the purpose or aim of corporate governance within this new model or schema would be to generate, protect, and exploit resources in order to maximize firm profits. Compare this with the more restrictive aim of corporate governance, under the agency theory, to distribute or apportion resources towards shareholder gain. The proposed model, based on the resource-dependence theory recognizes the potential utility of governance functions and
mechanisms towards meeting the firm’s broader strategic aim, and presents corporate governance a means of gaining competitive advantage.

This proposed view of governance is, however, not antithetical to the notion of shareholder value maximization. Enhanced firm profitability also implies shareholder benefit, particularly since the governance mechanisms which can so augment profitability would also have the effect of ensuring better governance decision-making to the advantage of all stakeholders, including shareholders. As a corollary to this aim, in the proposed model, gains arise from resource generation and appropriate utilization towards maximizing yield, in addition to the reduction of agency costs and inefficiency avoidance.

The model is based on a reconfiguration of the relative justificatory and explanatory roles of agency and resource-dependence theory. Consequently, in this model agency theory explains relationships between constructs, rather than the context or ground rules, of the relationship. Resource-dependence theory, on the other hand, explains the context of relationship, and justifies the origins of the domain, rather than being restricted to explaining relationship between constructs. This is essentially a reversal of roles, by comparison with the dominant agency theory-based view. However, the relative roles of other theories, namely, institutional and stakeholder theories remain the same across both the dominant agency model, and the proposed model: These theories are used to explain relationships between constructs, or elements within the knowledge system, and do not inform the knowledge system itself.

As a result, multiple governance aims can be satisfied, and various theoretical perspectives reconciled. For example, a resource-dependence view of stakeholders allows for better management based on prioritization stakeholder groups’, in keeping with their potential to provide, (or restrict access to), resources vital to the firm. This serves to resolve conflicts
amongst different stakeholder groups, including shareholders. Organizational resources are apportioned or distributed such that these resources in turn, generate the greatest yield in terms of access to other resources, and consequently support competitive advantage. In this way, shareholder value maximization priorities, and pressures to comply with institutional demands, can all be concurrently satisfied, along with the competitive imperative suggested under the resource-dependence theory.

3.1. Practical Implications

The proposed approach is particularly useful, given recent trends and events in the global governance environment. With governance failures such as that of Enron’s, and the consequent passing of the Sarbanes-Oxley Act in 2002, perspectives of corporate governance, which are well integrated with the multi-faceted nature of the governance environment, become all the more important. Approaching corporate governance as a part of the process of gaining competitive advantage can better integrate the various interests and the diverse mechanisms that are associated with corporate governance. This would increase the quality and efficiency of corporate governance at various levels. Governance systems are likely to change over time (Rajan and Zingales, 2003), to reflect political evolutions, such as listing requirements of stock exchanges, or the proliferation of international trade agreements. Corporate governance thereby becomes a dynamic tool to conform with, or satisfy, providers of resources, in the context of international business.

From a competitive perspective, the market environment positively evaluates better corporate governance. As agency issues are resolved, the venture is perceived as holding lesser risk for providers of capital. This in turn lowers the cost at which capital is available to the firm.
As firms compete for capital, corporate governance forms a key dimension on which they are compared. Thus, viewing the diverse constituents involved in corporate governance as suppliers of resources, and the governance mechanisms as methods by which to access these resources, can align policy goals with business motivations, towards improvement of governance quality.

3.2. Key Contributions

The advantages of conceptualizing the governance domain knowledge system as using the resource-dependence theory in a justificatory role; and the resultant schema as above, are three-fold: First, it may serve to enhance the debate on the utility and benefits of corporate governance, as well as provide insights towards resolving inconsistencies in empirical findings. This is likely to be most relevant to the scholarly community interested in corporate governance. Particularly, resource-dependence theory is the most comprehensive of all four main theories of corporate governance. In addition, it has been argued earlier that this theory accounts for the main explanatory principles of agency, stakeholder, and institutional theories, as well.

Second, from a practical standpoint, the use of this alternative epistemological perspective, and the resultant model, provide clearer directions by which managers and executives can use corporate governance towards firm gain. Managers can identify the appropriate governance initiatives, which are most relevant given the firms’ larger business and social context, and maximize the competitive benefits potentially arising from these initiatives. In this way, governance can be used as a tool of, or complement to, firm strategy.

Finally, the proposed model brings the notion of corporate governance in greater consonance with the broader business aim of gaining competitive advantage. So far, law and regulatory policy have been based largely on the body of knowledge generated using agency
theory. The underlying view is that regulation can also reduce uncertainty and curtain managerial excess (Rajagopalan and Finkelstein, 1992), a proposition that follows from the broader postulate that institutions help alleviate appropriability (Caballero and Hammour, 1998). To provide a specific example, evidence shows that the quality of firm corporate governance in a country is associated with the legal protection afforded to minority shareholders (La Porta et al., 2002). This finding can be linked to the idea that the focus of corporate governance is to protect the providers of capital. Consequently policy-making has been aimed at meeting this end.

Consider, however, a situation where the reasons that drive or motivate policy-making were to rest on resource-dependence theory, rather than agency theory. A hypothetical illustration that comes to mind is the use of regulation to constrain access to resources, as opposed to imposing punitive costs. That is, non-compliance would result in firms being barred from accessing certain resources, rather than the post-hoc imposition of fines and penalties. Such regulatory mechanisms are also more in consonance with market mechanisms, where similar competitive processes determine the degree of access, and the cost of access, to essential resources. Together, these potential applications present exciting possibilities for the future of governance research and practice.

4. CONCLUSION

This paper raises an essentially fundamental question: What is the purpose of corporate governance? Throughout this paper, I have argued for a change in the conceptualization of this purpose, and therefore a change in the knowledge system that we use to approach governance issues. I do not suggest that agency theory is no longer a valid point of view, but merely raise the question whether the changing business environment now presents exceptional situations where
the use of a different theoretical basis is justified. Given particularly the arguments in support of a change towards the resource-dependence view as a source of the domain knowledge system, it seems important to iterate that even within the new model proposed herein, agency theory plays a significant, in fact, essential, part. What this paper suggests is that we review the relative role of these theories, and revise the structure or configuration of the governance schema; so as to overcome the limitations that arise from over-reliance on the agency perspective.

Governance is intrinsically linked to the form, function, and purpose of the corporate entity, and must therefore be congruent with contemporary view of business, and relevant to business practice. Given this notion that governance and structure must adapt to suit emerging organizational priorities, the question arises: to what extent are conventional notions of desirable corporate governance really applicable? Despite its long-standing historical tradition and the eclectic disciplines of it origin, corporate governance is, and ought to remain, a dynamic domain.
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**Table 1**

**Justificatory and Explanatory Roles of Theory**

| **Justificatory Logic**                                                                 | **Explanatory Logic**                                                                 |
|----------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------|
| Justifies generation of a knowledge system for a subject or domain                     | Provides explanation for parts of the domain, usually a few constructs                 |
| Identifies components (actors and structures) and rules in the knowledge system        | Identifies relationships between constructs and elements in the knowledge system       |
| Explains properties of components in the system                                         | Explains outcomes of component interaction within the system, given their basic properties |
| Determines boundary conditions or contingencies                                          | Subject to boundary conditions or contingencies                                         |
| Can affect components in the system, their behavior, and outcomes                       | Should not affect relationship between constructs, though a different explanation for the phenomenon may arise. |
Table 2
Agency and Resource-Dependence Based Models: A Comparison

| Theoretical Basis of Model | Agency theory | Resource - dependence theory |
|---------------------------|--------------|-----------------------------|
| **Aim of Governance**     | Reduce agency costs | Generate and exploit resources |
| **Focus of Analysis**     | Emphasis on governance features | Emphasis on governance processes |
| **Performance Implications** | Performance enhanced through reduction in inefficiencies and agency costs | Performance enhanced through use of resources towards gaining competitive advantage |
| **Role of Agency Theory** | Justifies context of relationships | Explains relationships between constructs |
| **Role of Resource - dependence Theory** | Explains relationships between constructs | Justifies context of relationships |
| **Role of other theories** | Explain relationships between constructs | Explain relationships between constructs |
Figure 1

Components of Theory

- Observable Elements
- Underlying Constructs
- Base Knowledge System