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Corporate Governance : A Journey through the Literature Review

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Abstract.
Corporate Governance is a broad term defines the methods, structure and the processes of a company in which the business and affairs of the company managed and directed. Corporate governance also enhances the long term shareholder value by the process of accountability of managers and by enhances the firm's performance. It also eliminate the conflict of ownership and control by separately defines the interest of shareholders and managers. This paper reviews the extensive literature of corporate governance practices to find out the effectiveness of corporate governance mechanism in the companies and institutions. The paper also focuses on to reduce the principal-agent problem due to the effective corporate governance mechanism in the organizations.
***Keywords**: Corporate governance, agency theory, ownership, shareholders, managers.*

1.Introduction

Corporate governance is the broad term describes the processes, customs, policies, laws and institutions that directs the organizations and corporations in the way they act, administer and control their operations. It works to achieve the goal of the organization and manages the relationship among the stakeholders including the board of directors and the shareholders. It also deals with the accountability of the individuals through a mechanism which reduces the principal-agent problem in the organization. Fine corporate governance is an essential standard for establishing the striking investment environment which is needed by competitive companies to gain strong position in efficient financial markets. Good corporate governance is fundamental to the economies with extensive business background and also facilitates the success for entrepreneurship. During the last two decades the research area in finance is primarily focus on the area of corporate governance. The separation of ownership from control is the core of the agency problems facing by the firms (Berle & Means 1932; Jensen & Meckling 1976). This leads to many issues related to efficient control for the assets of corporations in the interest of all company's stakeholders. A great research has been done in the area of corporate governance by keeping the agency related problem. Core (1999) firms who have weaker governance to direct and manage company matter face greater agency problems. The agency problem allows manager to extract more private benefits and the firm ultimately performs worse. Firms therefore, needed for the improved corporate governance in order to survive for long term growth and survival. A good corporate governance can occur in the organization by putting the balance between the ownership and control and also among the interests of stakeholders of the firm. This approach might be helpful in developing the positive attitude among the manager and shareholders and reduces the agency problems in the firms.This paper presents the broad view of corporate governance from various perspectives and tries to link it with the agency problems where required. It gives an overview that how corporate governance handles the deviation between the mangers and shareholders interests. The mechanism of effective corporate governance will help to determine the difference between ownership and control by giving the view of topic from different angles and tries to solve the agency problems in the organizations.

2. Literature Review of Corporate Governance

Corporate governance importance arises in modern corporations due to the separation of management and ownership control in the organizations. The interests of shareholders are conflicting with the interests of managers. The principal agent problem is reflected in the management and direction related problems due to the differential interests of firm's stakeholders. There is not a single definition of corporate governance rather it might be viewed from different angles. Berle and Means (1932) and the even earlier Smith (1776). Zingales (1998) defines corporate governance as "allocation of ownership, capital structure, managerial incentive schemes, takeovers, board of directors, pressure from institutional investors, product market competition, labour market competition, organisational structure, etc., can all be thought of as institutions that affect the process through which quasi-rents are distributed (p. 4)". Garvey and Swan (1994) assert that "governance determines how the firm's top decision makers (executives) actually administer such contracts (p. 139)". Shleifer and Vishny (1997) define corporate governance as "the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment (p.737)". OECD in 1999 defined corporate governance as "Corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs. By doing this, it also provides the structure through which the company objectives are set, and the means of attaining those objectives and monitoring performance." Oman (2001) defined corporate governance as a term refers to the private and public institutions that include laws, regulations and the business practices which governs the relationship between the corporate managers and the stakeholders. The Ministry of Finance, Singapore (Corporate Governance 2001) defines corporate governance as "the processes and structure by which the business and affairs of the company are directed and managed, in order to enhance long term shareholder value through enhancing corporate performance and accountability, whilst taking into account the interests of other stakeholders. Good corporate governance therefore embodies both enterprise (performance) and accountability (conformance)." (Fin, 2004, pp 13-14). La Porta, Silanes and Shliefer (2000, 2002) view corporate governance as a set of mechanisms through which outside investors (shareholders) protect themselves from inside investors (managers). The Organization for Economic Cooperation and Development provides another perspective by stating that "corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the Board, managers, shareholders and other stakeholders, and spells out the rules and procedure for making decisions on corporate affairs. By doing this, it also provides the structures through which the company objectives are set, and the means of attaining those objectives and monitoring performance.

3. A View from Literature of Corporate Governance & Agency Theory

Mc Colgan (2001) gave a very broader view of agency theory and corporate governance. The major interest of his research was to cover the area that where the interests of managers diverge from those of the interests of shareholders. He kept in view the agency relationship and the agency cost which arises from these relationships. He extended the work of Jensen and Meckling (1976) who defined the agency relationship as a type of contract in which the principal keep the agent to carry out the services of the firm on his behalf. The agency problem arises due to the different interest and the conflict between the ownership and control as principal delegate some decision making authority to the agent. Jensen and Meckling (1976) argued that this delegation authority reduces the value maximizing decisions taking by the manager in the firm. Himmelberg,, Hubbard and Palia. (1999), argued Jenson and Meckling (1976) by saying that principal agent problem are not similar in all firms rather they are different in different firms, different industries and also in different cultures. Himmelberg et al. (1999) said that Jenson original theory "nexus of contract' suggest the same. McColgan (2001) agreeing with the authors said that agency problem can be reduces by the help of effective corporate governance mechanism which can be important in reducing the agency cost and the ownership problems in the firms. The governance should be design according to the firm environment as one general mechanism can be more important for some firms and less important for other firms. Okeahalam and Akinboade (2003) reviewed the issues and challenges of corporate governance in 2 Africa. They presented the reason for their review that many of the non financial corporations failed in the United States and in Asia due to the non efficient corporate governance. They said that Africa can learn a great from the experiences of these countries and may improve the governance for its corporate sector. Okeahalam and Akinboade (2003) conducted the review by studying a contribution on the corporate governance in Africa and said that the modern concepts of separation of management from the ownership make the corporate governance an important issue for research. The interests of people who control the organizations are differing from those who invest in the company by external finance. Also the principal agent problem and the interest of shareholders can only reduced through the effective corporate governance. Okeahalam and Akinboade (2003) stated that the organization systems, practices, process and rules of governing institutions are concerned closely with the corporate governance so there is a need to find those relationships that regulate, create or determine the nature of relationship through those relationships. Corporate governance implies that companies should balance between the interests of shareholders with stakeholders at all levels of organization. Okeahalam and Akinboade (2003) stated that Africa is highly influence by mismanagement, corruption in business environment, therefore effective corporate governance can create the transparency and safeguard against these threats facing by the companies to promote the foreign investment by foreign traders and companies. The authors stated that research publication in the area of corporate governance is very low and suggested that the research should be promoted in both empirical and theoretical ways. Farinha (2003) conducted the theoretical and empirical literature review to find out the true nature and consequences of corporate governance. The main focus of his literature was to find out the reasons of conflict between manager and shareholders in organizations with respect to ownership mechanism. He also tried to find out the link between the corporate governance and the value of the firm. Farinha (2003) argued that major problem in organization arises with the relationship of principal and agent relationships and a different approach of manager than the shareholders. The perspective of the manager remains with the limited cash-flows thus managers focus lies with the short term perspective on investment whereas shareholders stuck with the quick return of cash flows. Risk preference is also a major source of conflict between the principal and the agent. Shareholders associated with the market risk and the risk of stock returns whereas managers always concerned with the company risk because their survival depends on the firm risk. The area of corporate governance is lacking with the external disciplining devices. The firms through the effective corporate governance can implement these devices which includes the composition of the board of directors, increase number of shareholders, maximize the inside ownership and by providing different financial policies and compensation packages. Filatotchev, Lien and Piesse (2004) studied the Corporate Governance and Performance in Publicly Listed, Family-controlled Firms in

Taiwan. They analyzed the effects of the structure of ownership and board characteristics on performance in large, publicly traded firms which are controlled by family controlled firms. The authors argued that firms located in East Asia, operate with a distinctive culture and in different legal and institutional environments than west and Europe, These culture differences may have a strong impact on governance-performance relationships suggested by the study of agency and strategy research. The authors did not find a direct association between family ownership and managerial entrenchment and extraction of the private benefits of this control, which might be the negative cause to financial performance. The authors also identified the differences in corporate governance effects which are associated with different types of institutional shareholders. Filatotchev, Lien and Piesse (2004) suggested that foreign investors may attract to the Taiwan markets by the process of globalization which may lead to good corporate governance being imported by the domestic firms in Taiwan. The results of their study also find that family control over the executive board is the major determinant to the performance. Becher and Campbell (2004) studied the corporate governance of bank mergers and acquisitions. He was of a view that during these mergers and acquisitions the CEOs negotiates for their own interests whereas the outside directors of the company face the financial problems. The corporate governance of independent companies affected a lot.Becher and Campbell (2004) made empirical investigation to find out the effects of personal benefits and the merger premiums by taking a sample of 146 mergers of large US banks in 1990s. They targeted the two thousand directors and executives during these mergers and found that target's merger premium is inversely related to the number of target directors who are retained during these mergers. This also implies for the corporation size, incentives, payment methods and bidder returns. The 3 study found that the interests of target director relatively lies with the size of the company rather than performance and they exercise their bargaining power with the acquirer which counters the interests of shareholders interest in the merger. Novikova (2004) studied the impact of internal corporate governance system on firms innovative activities and addressed the question that how much firms internal corporate governance system varieties with the type and efficiency of firm's innovative activities. Novikova (2004) listed out major participative actors for the firms which are the board, the shareholders, the managers and the other stakeholders for the companies. He defined the institutions as the rules and procedures use to make decisions on corporate affairs of the firm. Novikova (2004) designed his research on the definition of OECD which defines corporate governance in a narrow term as a relationship between a company and its shareholder whereas in broader term the relationship between the company and the society. Kowalewski, Stetsyuk and Talavera (2007) studied the corporate governance practices in determining the dividend policy in Poland. Jensen (1986) said that dividends can reduce the agency costs because of the distribution of free cash flows that can be spent on the unprofitable projects by the firm's management. Gompers, Ishii, and Metrick (2003) in their research on agency cost also said that agency cost is the strengthen relationship between the shareholders rights and its associated with the corporate governance. Kowalewski et al. (2007) studied the view of many authors in their extensive literature on the topic and found that by empirical implications that corporate governance is an important determinant for explaining the dividend policies. They also found that larger asset retain companies and highly profitable firms without good investment opportunities pay more dividends whereas the high risks and indebt firms pay low dividends. In Poland the companies with strong corporate governance practices and strong shareholder rights pays higher dividends and it mitigates the agency problems in the Poland. Another study conducted by Cueto (2007) to find out the role of ownership mechanism and corporate governance practices in emerging markets of Latin America. In context of weak shareholder protections the corporate governance mechanism affects the firm value, the liquidity of market and the organization of industries. Cueto (2007) proposed that the relationship between the corporate governance mechanism and the firm's value and the effects of ownership structure and among the liquidity of the stock market must be explored.

4. Conclusion

In this review which is a collection of volume of research on corporate governance the significance of effective corporate governance is being evident. The aim of the review done is to check the effectiveness of corporate governance and its effective mechanism in running and managing the business operations. The issue of ownership and control and the principal-agent problem and its effect on corporate governance is the main area of research in this review. The findings of the most studies show that effective corporate governance reduces the ownership and control problems and draws a clear line between the shareholder and the manager. Finally from the discussion from all articles this review provides a general overview of principal-agent problem and ownership and control for the researchers and academic practitioners in the domain of corporate governance.

5. Limitations of the Study

There are many limitations in the review conducted in this paper which can be associated with the lack of time. Due to shorter period of time the study is conducted only by focusing on studies taking from the perspective of different countries. Each country is located in separate region and the cultural aspect of different nations can influence the practices of the business and its corporate governance. Due to the shortage of time the empirical aspect of study never being came into focus. More attention should be focus on the practical aspect of the corporate governance and its practices in real business environment need to be study closely.

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