"Dimitrie Cantemir" Christian University
Knowledge Horizons - Economics
Volume 7, No. 4, pp. 9–14
P-ISSN: 2069-0932, E-ISSN: 2066-1061

www.orizonturi.ucdc.ro

CORPORATE GOVERNANCE – KEY FACTOR TO ENHANCE PERFORMANCE

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Abstract *Corporate governance is a topic of great interest in the current economic climate being widely debated in scientific economic papers and can be defined as the system by which companies are directed and controlled, but also can be seen as the relationships between companies and their stakeholders. In correlation to firm performance, corporate governance assures the framework in defining the firm objectives and the means by which these can be achieved, also assuring the monitoring of obtained results. The issue raised by both practitioners and academicians is whether corporate governance can really enhance performance, this being more highlighted in the current development of economy. Globalization requires new standards of performance that exceeds the economic field, both for domestic companies as well as international ones. So, these standards should be integrated into corporate strategy development to ensure sustainability of activities undertaken by harmonizing the economic, social and environmental objectives.*

Key words:
Corporate governance, firm performance, corporate social responsibility, corporate governance index
JEL Codes:
G30

1. Introduction

Corporate governance has become one of the most used phrases in the language of global business. The global financial crisis that swept the financial markets and economies around the world, causing bankruptcies and resulting economic recession has pushed the concept of corporate governance in the spotlight.

With the development of the economy and the formation of a common market, there has been an upward trend in global interest in forms of leadership, both in private entities and public institutions designed, known as corporate governance. Crisis-related events have drawn particular attention to internal control systems, risk management and economic entities' performance. Following the corporate scandals and the global financial crisis, corporate governance has received significant attention from the regulator and the public. Regulatory measures have focused on increasing the disclosure requirements related to corporate governance, and this has led to increased awareness and demand for assurance on internal corporate governance processes.

At the national level there is a growing interest on corporate governance and firm performance because through firm performance is achieved a great amount of the degree of economic development (Iwu-Egwuonwu, 2010). This interest can be motivated by the fact that companies are taxpayers and the level of their performance determines the level of revenues included by the governments in their annual budgets supported by different taxes collected from companies. The result of this interest takes the form of the Corporate Governance Codes developed at national levels.

We also have to consider that sustainable development and, therefore, globalization require new standards of performance that exceeds the economic field, both for domestic companies as well as international ones. So, these standards should be integrated into corporate strategy development to ensure sustainability of activities undertaken by harmonizing the economic, social and environmental objectives. To achieve both financial and non-financial objectives companies must do well, this being assured by good governance.

The current economic dynamics and fierce competition on all markets regardless of the profile require major changes in the leadership system of enterprises and adopting a new management behavior. In this context, more often the performance management system and corporate governance are applied as modern and efficient systems of management (Lenghel, 2005, quoted by Cosneanu *et al*., (2013)).

"The 19th century saw the foundations being laid for modern corporations: this was the century of the entrepreneur. The 20th century became the century of management: the phenomenal growth of management theories, management consultants and management teaching (and management gurus) all reflected this preoccupation. As the focus swings to the legitimacy and effectiveness of the wielding of power over corporate entities worldwide, the 21st century promises to be the century of governance" (King Report, 2002, p. 15).

2. Conceptual Issues Regarding Corporate Governance and Firm Performance

The term "good corporate governance" was first mentioned in 1932 by Adolf Berle and Gardiner Means in their heory of agency. Tricker (1984) considers as components of corporate governance: corporate strategy, executive management, accountability and oversight. Since the 1990s, corporate governance has been seen as an essential ingredient for economic development. Cadbury (1992) regarding the definition of corporate governance, suggested that "corporate governance is the system by which companies are directed" not taking into account external elements such as markets, banks and advisers who's practice greatly affects how each national system works.

Shleifer and Vishny (1997) highlight the financial aspects of corporate governance in their work and define corporate governance as how the fund providers of a company shall ensure that they will receive the benefits payable on the investment made.

While Grant defines corporate governance as "a broad theory concerned with the alignment of management and shareholder interests" (Grant, 2003:923), others authors such as Ahmmed Momtaz Uddin and Mohammad Abu Eusuf consider that corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals (Ahmmed and Mohammad, 2005).

A complex definition of corporate governance is given by Jamali *et al.* (2008) in their paper *Corporate Governance and Corporate Social Responsibility Synergies and Interrelationships* taking into account others definitions of the concept „corporate governance thus generally revolves around a set of universal attributes, including ensuring accountability to shareholders and other stakeholders (Keasy and Wright, 1997), creating mechanisms to control managerial behavior (Tricker, 1994), ensuring that companies are run according to the laws and answerable to all stakeholders (Dunlop, 1998), ensuring that reporting systems are structured in such a way that good governance is facilitated (Kendall, 1999), crafting an effective leadership/strategic management process that incorporates stakeholder value as well as shareholder value (Tricker, 1994; Kendall, 1999), and enhancing accountability and corporate performance (Keasy and Wright, 1997). Leadership, direction, control, transparency, and accountability attributes thus lie at the heart of sound and effective corporate governance (Huse, 2005; Van den Berghe and Louche, 2005)" (Jamali *et al*., 2008: 445).

Corporate governance was an issue that concerned international institutions such as Organization for Economic Cooperation and Development (OECD), that defined corporate governance as the system by which companies are directed and controlled, and refers to how rights and responsibilities are divided between the main actors of an entity. OECD has developed a framework for corporate governance known as OECD Principles of Corporate Governance. The principles are presented in the following table.

Table 1: Principles of Corporate Governance

Principle	**Content** ***„The corporate governance framework should...***
Ensuring the Basis for an Effective Corporate Governance Framework	… promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities."
The Rights of Shareholders and Key Ownership Functions	… Protect and facilitate the exercise of shareholders' rights."
The Equitable Treatment of Shareholders	… Ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights."
The Role of Stakeholders in Corporate Governance	… Recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises."
Disclosure and Transparency	… Ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company."
The Responsibilities of the Board	… 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."

Source: OECD, 2004: 17-25

The OECD Principles contain a guide on how to make decisions concerning the company's activity regarding defined strategic objectives, regarding the means of achieving them, but alsoon how to monitor financial performance (OECD, 2004).

In general, the term "corporate governance" refers to the process or processes by which an organization is directed and controlled (Edwards *et al*., 2012). When it comes to corporate governance the discussion is about authority, responsibility, management, leadership, guidance and control, all of which are exercised in the organization. Since it is a multi-dimensional concept, the term "governance" is used differently depending on the analytical point of view of the observer or look under control (Edwards *et al*., 2012).

In other words, the concept of governance is defined as a combination of processes and structures implemented by the administration, whose role is to inform, direct, manage and monitor the activities of the entity towards the objectives.

One of the main objectives of corporate governance systems is to obtain performance. In the current economic context, the companies need to obtain global performance. So, performance is seen in a holistic manner, representing the aggregation of economic, social and environmental performance (Alazard and Separi, 2001; Reynaud, 2003; Robu and Vasilescu, 2004; Baret, 2006; Mironiuc, 2009).

If in the last century the fore was on financial performance, companies have now realized that this is only the outcome of the race, but the race itself and the vector of the success of today's racing, in the context of sustainable development of society, is what we call global performance, seen by Bachet as "an emergent property that shouldn’t be reduced to the amount of partial performances, but to an overall performance which is based on a virtuous link between the economic and social and on a long-term concern for success" (Bachet, 1998). Global performance concept is present in the literature to assess the implementation of business strategies in the context of sustainable development. The concept is the reflection in the management system of the macroeconomic concept of sustainable development (Capron and Quairel, 2005).

According to Iwu-Egwuonwu (2010) performance, in relation to corporate governance “can be seen … as the success in meeting pre-defined objectives, targets and goals. Firm performance is thus the effectiveness of a firm in achieving the outcomes it intends to achieve within specified time targets. These outcomes can be explained as the measures by which the firm is evaluated, and broadly include the quality of governance. Governance quality of the firm is measurable by: the quality of firm financial performance or attainment of high financial performance goals; the total valuation of the firm; firm reputation; firm corporate social responsibility; firm’s stock returns/share value; ethical behavior of the firm; the technological asset through which it produces its product/services; board being controlled by more than 50% of independent outside directors; the board of directors having access to outside advisers; shareholder rights; transparency/ information disclosure; board independence and chairman independence; legal protection of minority shareholder rights; observance of corporate governance standards; governance behavior; compliance with codes of best practice; ownership structure, and so on” (Iwu-Egwuonwu, 2010:7).

In the current globalization of world economy, a company that registers performance is a "company that creates added value for its shareholders, satisfies customers demand, takes into account the opinion of employees and protects the environment. Thus, ownership is pleased that the company has achieved the desired return, customers have confidence in the future of the company and in the quality of its products and services, company’s employees are proud of where they work, and society benefits through policy adopted by the enterprise, of environmental protection” (Jianu, 2006).

After our incursion we can say that the concept of corporate governance is in a process of adaptation to the requirements of a modern economy, globalization increasingly obvious and to the information needs of investors and interested third parties in the business, especially regarding the concept of sustainability. „Corporate sustainability is understood as the ability of companies to positively influence environmental, social and economic development through their governance practices and market presence” (Krechovská, and Procházcová, 2014:1144).

3. Literature Review Regarding the Positive Corporate Governance-Performance Correlation

Currently, there are numerous studies and empirical evidence showing that certain fundamental mechanisms of corporate governance play a key role in companies’ performance improvement, primarily through ease their access to capital markets, which increases investor confidence and increases competitiveness. The increase of companies’ transparency is assured by applying the principles of corporate governance, this being a concern for both managers of listed companies and the authorities.

After studying the literature on this regard we found that many empirical studies use a single governance variable or mechanism in investigating the relationship between firm performance (Yermack, 1996; Bhagat and Black 2002). But due to the fact that corporate governance is a complex phenomenon other authors

(Gompers *et al.* (2003); Brown and Caylor (2006)) consider that corporate governance should be measured using a corporate governance index (CGI - a multidimensional variable).
The literature testing the relationship between different corporate governance mechanisms and firm performance is extensive. Studies use different variables to assess corporate governance such as: CEO duality, board size, proportion of non- executive directors, board committees, ownership structure and concentration, managers' compensation and incentives schemes and others, while for performance the measures used are Tobin's Q, return on equity (ROE), return on asset (ROA) and others.
In the following table we present some of the empirical studies found in the literature that evidence the fact that corporate governance is a factor that enhances performance

Table 2: Positive correlation between corporate governance and firm performance in the literature

Authors	Mechanisms of corporate governance	Findings
Klein (1998), Weir and Laing (2000)	remuneration committee	remuneration committee has a positive link with firm performance measured by ROA, productivity and market returns
Laing and Weir (1999), Black and Kim (2012)	audit committee	positive correlation with firm performance using ROA and Tobin's Q
Jackling and Johl (2009), Adams and Mehran (2012)	board size	positive significant correlation with firm performance measured by ROA and Tobin's Q
Adams and Mehran (1995), John and Senbet (1998), Bhagat and Black (2002)	structure of board	the right mix of internal and external managers can enhance performance
Weir et al. (2002), Gupta and Fields (2009)	structure of board	positive correlation between the proportion of non-executive directors and firm performance
Ntim and Oser (2011)	attendance at board meetings	firm with good attendance at board meetings perform better than firms with low attendance
Kaserer and Moldenhauer (2005)	managerial ownership	positive link between managerial ownership and firm performance
Henry (2008); Iatridis (2008)	disclosure and transparency	voluntarily disclosure can be considered as one of corporate governance mechanism that enhances performance
Toksal (2004)	disclosure and transparency	corporate governance reporting reduces the cost of capital
Gompers *et al*. (2003), Bhagat and Bolton (2008)	G-Index	strong correlation between G-index and the following financial indicators: stock performances, Tobin's Q, net profit margin and sales growth
Drobetz *et al*. (2004)	Corporate Governance Rating (CGR)	positive correlation between corporate governance and firm performance (better-operating performance, higher market valuation)
Beiner *et al.* (2005)	Corporate Governance Index (CGI)	positive correlation between CGI and Tobin's Q
Brown and Caylor (2006)	Gov-Score index	positive correlation of the index with firm value (Tobin's Q)
Cheung *et al.* (2007)	Corporate Governance Index (CGI)	correlation between CGI and market to book value (firm value)
Bebchuk *et al.* (2009)	"*Entrenchment index*" (E-index):	the decrease of governance performance is correlated with negative extra-returns

Source: *Own precessing*

So, after all these mentioned studies we consider that companies in order to survive in global market, increase their performance, become more competitive, profitable, attract investors, customers and raise capital at lower price, they must implement corporate governance principles and standards in their strategy and decision making process (Tudorovic, 2013). "Good corporate governance is not only about high financial performance, it is about high achievement and performance within the line of activities, purpose, vision and mission of an organization" (Iwu-Egwuonwu, 2010:4).
The importance of implementing corporate governance is essential in attracting important investors. Recent studies even make the link between companies' performance and effectiveness of corporate governance applied model (Briciu, 2012). Also investors granted great importance to corporate governance systems implemented in companies and are willing to pay extra for good results in this field.

4. Conclusion

Good corporate governance is an important step in building market confidence and to encourage long-term investment flows. In many countries the implementation of corporate governance practices is seen as a way to improve economic dynamism, thereby improving overall economic performance.

Corporate governance is a concept that encompasses a wide range of activities, rules, processes and procedures to ensure optimal use of resources and corporate strategies so that its objectives are achieved.
Corporate governance should ensure the success of an entity is durable, and value creation for stakeholders. Successful organizations have a corporate governance and culture that goes beyond compliance with regulations and supporting the organization's efforts to improve performance.
“In a more globalized, interconnected and competitive world, the way that environmental, social and corporate governance issues are managed is part of companies’ overall management quality needed to compete successfully. Companies that perform better with regard to these issues can increase shareholder value by, for example, properly managing risks, anticipating regulatory action or accessing new markets while at the same time contributing to the sustainable development of the societies in which they operate. Moreover these issues can have a strong impact on reputation and brands, an increasingly important part of company value” (Who Cares Wins: Connecting Financial Markets to a Changing World, p. i, UN Global Compact, 2004).
The review of the literature indicates that prior corporate governance and entities performance studies have extensively employed data on the specific governance mechanisms and governance indexes. This offers a chance to extend prior studies by incorporating questionnaire surveys regarding directors’ opinions on corporate governance and firm performance.

5. Acknowledgements

This work was supported from the European Social Fund through Sectorial Operational Programme Human Resources Development 2007 – 2013, project number POSDRU/159/1.5/S/142115, project title “Performance and Excellence in Postdoctoral Research in Romanian Economics Science Domain”.

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