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Corporate Governance And Firm Performance

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Abstract

The primary purpose of this paper is to examine the relationship between corporate governance and firm performance. The researcher used an analytical research method as it is suitable for this study. This research paper is based on secondary data. The main findings of this study are that there is a positive relationship between corporate governance and firm performance. Good corporate governance has a good impact on firm performance. The researcher suggested some appropriate recommendations and suggestions enhance the corporate governance roles in the firm performance.

Keywords: Governance, Corporate, Relationship, Firm, performance

1. Introduction

Corporate governance defined as systems of the framework, relationships within processes, in which corporations worked and controlled by the authority. The authority controls the companies, including control program and accountability (HIH Royal Commission, 2003). Recently, considerable attention had been received to corporate governance because of WorldCom, Enron, Adelphia and other memorable scandals, that acted as an impetus for such United States systems as the Sarbanes-Oxley 2002, in the 70 years ago, the corporate governance system considered the most totalitarian (Byrnes et al., 2003).

The best-governed firms must act in a higher quality than those worst governed firms as best corporate governance correlated to best the corporation performance. Firms managers have intentions to confiscate company assets by executing projects that they personally benefit, but negatively impact shareholder wealth (Jensen and Meckling, 1976; Fama and Jensen, 1983; Shleifer and Vishny, 1997). The “control rights” reduces by efficient corporate governance that creditors and Shareholders owe to managers, arising the likelihood that affirmative net existing projects can be invested by managers (Shleifer and Vishny, 1997), supposing the best operating performance leads to best-governed firms, the first proxy of us to performance of the firm. Corporate governance structures and practices continue to be important in determining the cost of capital in a global capital market.

Corporate governance, according to Dennis (2001), includes a range of market and institutional processes that motivate themselves, interested managers, to increase the value of the company’s remaining cash flows on behalf of its shareholders. This study highlights the main seven ways to lessen the problems of agency placed in McColgan (2001). These are financial policy corporate, boards corporate, shareholders and managerial ownership, institutional investors, managerial remuneration, the corporate control market and the managerial labour market. The internal control mechanisms categorized the first five mechanisms, whereas the external control mechanisms categorized the latter two. The governance mechanism to be effective, the gap between the interests of manager and investors should be narrow, and possess a positive and significant impact on performance and value of corporate (Denis, 2001).

Hermalin and Weisbach (1998) mention that the alteration in board composition came from weak performance; therefore, any cross-sectional slope of performance on the composition of the board will be prejudiced due to board composition changes only the result of past performance. According to Hirshleifer and Thakor (1994) and Warther (1998), mentioned that the interests of directors are consistent with those of shareholders to reputation concerns and compensation incentives. Fama and Jensen (1983b) suggest that to establish better governance, the effective boards must consist largely of independent directors. Jensen (1993), mention increasing the size of the board might harmful to the value of the company because when the too big board, the manager's free ride inside the board increases and the board becomes less part of the management process and more symbolic.

According to Jensen (1993), the board size raising might be harm to the firm value because when the panels become too large, the manager’s free ride inside the board increases and the board become a management process in a less part and more symbolic. Managers of self-serving want to increase the size of the board after its maximizing value level. Therefore, the agency model prognosticates a reverse relationship between performance and board size. Moreover, the composition of the board, the monitoring process and the role of directors were analyzed by some researchers. Weisbach (1998) explained that the outside directors are concerned with their reputation, so they are considered active monitors more than inside directors.

Moreover, in discipline, the CEO / management, the outsiders are not efficacious except the mismanagement evidence is strong enough; this agreed with Warther (1998) and Hermalin and Weisbach (2003). Additionally, Mace (1986) reported that tends of the CEO to control the process of director-nomination and to refuse the independent directors nomination. The top executives have different beliefs than those beliefs of CEO, Landier et al. (2006) argued that a key feature of good corporate governance is the disagreement of executives.

Adams (2002) concentrated depend on the conflict between the advisory functions and surveillance of the board. May choose the board as a result of a prior commitment to limit its control to the director in order to director encourage to share his information. Bhagat & Black (2002) explained the board size and performance in previous studies are not strong to value in various measures. They conclude that the use of different scenarios in different board types. Consequently, boards of insider-dominated may be more useful for tasks that cannot be observed. Shleifer and Vishny (1997) literature survey on the debit role in the conflict of interests reducing between shareholders and managers. Jensen and Meckling (1976) mention that the less equity resulting from higher debt, consequently, allows insider ownership at a higher level. Jensen (1986) proposed that debt was linking mechanism better than payment dividend to enable payment future cash flows by the managers, particularly in cases where there are few internal growth opportunities for companies.

Firm value improves due to debt because it liquidation decision improves by making more likely default (Harris and Raviv, 1991) and the managers’ forces of external capital market to take strategies to maximize value (Easterbrook, 1984). However, the debt usage results also in higher levels of agency costs associated with debt and costs of bankruptcy. For example, Stulz (1990) & Harris and Raviv (1991) showed that underinvestment might come from the debt because of the raising new finance costs.

2. Literature Review

In the last two decades, conducted many empirical studies to evaluate the relationship between corporate governance and the performance of firms across the world. Sometimes corporate governance is seen as a culture business economic growth fostering by building investors confidence (The Commission Report HIH Royal 2003). Schmidt and Tyrell, (1997) used a more concise of company definition: “corporate governance is the sum of the organizational and institutional mechanisms, and the corresponding making decision, control rights and intervention, that act to conflicts of interest resolve amid the different groups that have a share in the company which, in their interaction or isolation, important decisions in the firm determine how they are made, and also the decisions that made determine ultimately".

Some endogeneity found between firm performance and corporate governance in previous studies. Such as Vafeas (1999), recorded that the frequency of board meetings is correlated negatively with the valuation of the firm while increased meetings frequency of board is positively correlated to performance operating in future. When corporate governance changes, the positive correlation between company performance and corporate governance is most evident, consequently, any return of cross-sectional regression on the composition of the board will be biased due to the corporate governance changes might result from past performance only. Comparing previous studies, my methods were critical betterment that usage of change analysis and scoreboard data in corporate governance rather than the level of corporate governance, which lower the endogeneity problem.

The effect of governance change in the performance of the firm has been examined by a few studies. Nesbitt (1994, 1995, 1997, 2001); Carletn *et al*. (1998); Catn *et al*. (2001); English *et al*. (2001); Ansn *et al*. (2003) who discussed how high yields in active funds can be gained by improving their governance structures and buying lower governance shares. The better cash management of stronger governance firms leads to the increasing value of the firm. Jensen and Meckling (1976) suggest that firms with better-governed are more probable to invest in gainful schemes, leading to higher cash flows in the future. La Porta et al. (2002); Shleifer and Wolfenzon (2002); Durnev and Kim (2005) explained that perfect governance prohibits managers from controlling shareholders or expropriation. Forth the theory was put by Jensen (1986), provided that the resources under the managers' control were reduced by good governance, thence, the chance of managers expropriation reduces indirectly.

The capital cost reduce as a result of good governance either auditing costs and the reduction of shareholders' monitoring (Lombrdo and Pagno, 2000b; Garmase and Lu, 2005) or through the decrease of the asymmetric information (Easley and O'Hara, 2002; Leuz and Verrecchia, 2004). The activities of decreasing value were definitely by Jensen and Meckling (1976) as an unsuitable investment, consumptions of managers' perquisites and corporate resources stealing. The firm value enhanced by corporate governance by minimizing these activities. Shleifer and Vishny (1997) mentioned that the firms that are better-governed invest in successful projects lead to operations in higher efficiency and more expected cash flows in the future.

There are different interpretations by the theoretical papers, but sometimes they overlap. La Porta et al. (2002); Shleifer and Wolfenzon (2002); Durnev and Kim (2005) who mentioned that investors are more shares like to pay if they realize that more of the profits of the firm shall be repaid to investors first than impounded by the governing enterpriser. John et al. (2005) show that the perks optimal level was reduced by good corporate governance; thus, the directors like to risky invest but productive projects. Jensen (1986) discusses that the resources decrease by good corporate governance under the control of managers, lead to lessen the problem of free cash flow. Lessening of outflow of free cash was interpreted as an indirect reducing way of capital waste because now managers have discretionary resources in limited to proper. Reducing information asymmetry due to capital cost reduces by Corporate governance.

Analytical research proposed that information plenty must be decreasing the capital cost through estimating risks reduced, and transaction costs reduced — the empirical literature surveys on the capital cost and information risk by Habib (2005). The empirical literature was summarized that seems at danger news from the viewpoint of (1) corporate governance, (2) expose quality and (3) earnings quality.

3. Significance of the Study

To the best knowledge this paper is the first in Iraq to evaluate the role of good corporate governance in the firm performance. Moreover, This study will be of great important to the decision makers, shareholders, government Officers, Academicians, Researchers and Students. The significance of this study can be illustrated in the figure below:

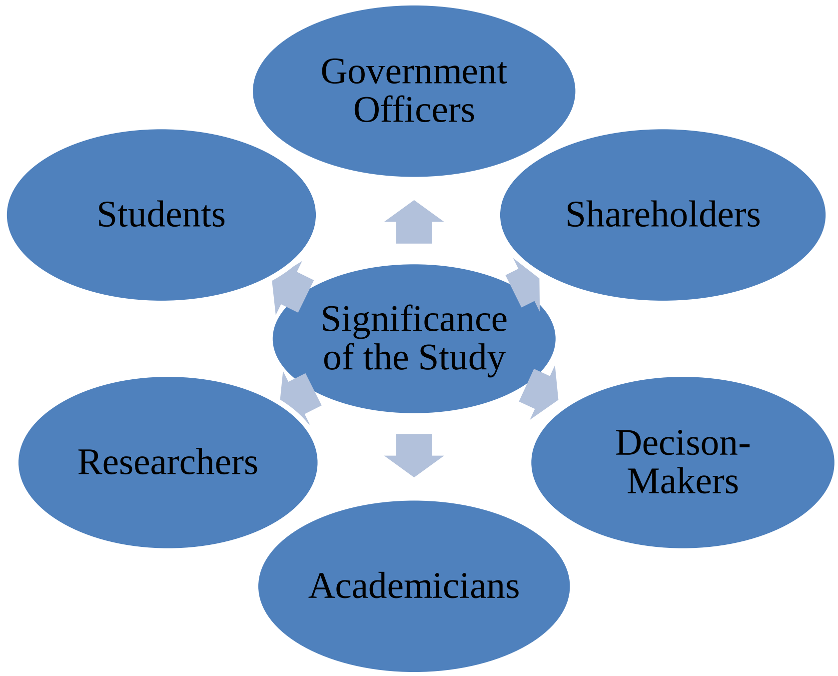

Figure1: Significance of the Study

4. Problem Statement

From the reviewed literature, the researcher found that most studies do not assess the corporate governance role in the firm performance. Therefore, this is the first study in Iraq to examine the role of good corporate governance in the firm performance. Also, this study shall discuss the Agency problems role in the firm performance. Moreover, this study will review the Corporate Governance Mechanisms role in the firm performance. Furthermore, the present study will investigate the Corporate Boards role in the firm performance. Finally, the present study will investigate the Corporate Financial Policy role in the firm performance.

5. Objectives of the Study

To successfully operate, the competent corporate governance structure is necessary for the firm. All the time, if a company judged its existing insufficient corporate governance tools to suitable showing insurance, will evolve to improve it. However, the research primary objective is to examine the impact of good corporate governance in the firm performance. The main objectives of this paper are as follows:

1. To present an overview of corporate governance.
2. To examine the role of Agency problems in the firm performance.
3. To examine the role of Corporate Governance Mechanisms in the firm performance.
4. To identify the role of Corporate Boards in the firm performance.
5. To examine the role of Corporate Financial Policy in the firm performance.
6. To suggest based on the findings of the study the most appropriate recommendations for an effective corporate governance in order to enhance the performance of the firms.

6. Research Methodology

The research aimed to assess the joint between firm performance and good corporate governance. The researcher uses analytical research as it suits this study. This research paper is based on secondary data; research papers, books, Master Dissertations, Published & Unpublished Ph. D Thesis, etc.

7. Findings and Discussion

Equity capital cost lowers through corporate governance by reducing the monitoring cost of outer investors. According to Jensen and Meckling (1976), investors should bear the costs of monitoring to deal with problems of agency, and higher rates required for rational investors of returns for such agency costs taking.

The firms' systematic risk is affected by corporate governance. In global fully integrated capital markets without external finance agency costs or transaction, the CAPM traditional prognosticate that equity expected returns depend only on the covariance risk level with the portfolio of the global market, and there is no power of explanatory for the level of country- and/or corporate governance factors in the firm level.

The results of the current study also indicated that compensation to board leads to contribute positively to the performance of the firm. As a result, the listed firms necessary to consider competitive and appropriate compensation level of members of the board. The compensation will support the best relationship between corporate managers and shareholders, this relation leading to firm performance enhancement to maximize the value of the shareholders.

By having a Nomination Committee in proper working, lead to play an active role in donation of the investors a fundamental comfort regarding Board appointments.

8. Suggestions

1. The board should not be too much members because the most significant board size negatively contributes to the performance of the firm. Female board members should appoint in the board because they will make an active contribution to the performance of the firm due to these females.

2. Companies must disclose and establish the particular roles and responsibilities of management and the board; Companies should be purposes maintained create to the board and those agents to senior managers and those facilities disclose.

3. Companies should have a compelling composition of the board, commitment and size to appropriately discharge its tasks and capacities; independent directors should be the majority of the board, independent director should be the chair, the alike person should not apply the tasks of chief managing director and chair, the committee of nomination should establish in the board.

4. Companies must promote ethical actively and making responsible decisions; they disclose the code and code of conduct or a summary of the code must be established through the companies. The practices needed to maintain confidence in the integrity of the company, the practices needful to take account of its legal obligations and the reasonable stakeholders' expectations, the individuals' accountability and responsibility for reports of investigating of unethical practices and reporting.

5. The balanced disclosure must enhance timely by the companies for any tool items around the firm.

6. Companies must respect the shareholders' rights of and simplify the Rights exercise effectively; it is also the duty of firms to promote effective communication with shareholders by designing a communications policy, summarizing that policy and promoting their cooperation in overall meetings their policy discloses or of that policy.

7. Companies must institute a monitoring risk sound system, internal control and management. Companies must institute monitoring policies, management of risk material business and those policies summary disclose.

8. The internal control management system should be implemented and designed to control the firm trading dangers and list to them, which these risks effectively managed.

9. Information on whence others are doing guided to fuse management dangers inactivity of decision building and the most effective risks should be provided to the board.

10. The board should expose that management has reported to it as to the company management effectiveness of its risks of the material business.

11. Companies must guarantee that the composition of remuneration and the level is reasonable, sufficient and that clear of performance relationship.

12. Effective and transparent markets should be encouraged within the framework of corporate governance, be consistent with the rule of law and clearly demonstrate the division of responsibilities between the various enforcement, regulatory and supervisory authorities.

13. Facilitating and protecting the exercise of shareholders' rights should be the responsibility of the corporate governance framework and ensure that all shareholders are treated fairly, especially foreign shareholders and minority groups when the violation of shareholders rights should be given the opportunity to obtain adequate compensation.

14. The The stakeholders' rights stabilised by law or by reciprocal agreements and active cooperation among companies and stakeholders should be engaged in producing works, fortune and supportable of enterprises financially intact.

15. The structure of corporate governance should confirm that accurate disclosure and timely made on all objects material concerning the corporation, including the performance, financial situation, management of the firm and ownership.

16. The framework of corporate governance must warrant the company guidance strategic, the board management of effective monitoring, the board’s responsibility to the firm and the shareholders.

17. The capital cost must involve a premium risk displaying insiders’ susceptibility to risk of idiosyncratic.

18. The media play an essential role in understanding corporate governance and raising public awareness, perhaps as a monitoring dog in corporate governance.

19. The company secretary must conduct the audit in practice; the secretariat auditor submits a secretarial audit report to the board of directors / corporate compliance committee.

20. The board decisions must be held fulfilling the largest attention of the company in view.

21. Management must be aware that they are the trustees of the shareholders' wealth for the reason of social interest rather than their profit.

22. Building trust among stakeholders is an urgent need, restoring it and improving the credibility of the Council's independence.

23. The remuneration policy must explain and disclose for the executives and board members. Executive remuneration packages should include an equilibrium between incentives and fixed remuneration, mirroring long and short term showing goals suited to the company's aims fitting to the company's goals and circumstances.

24. Companies must make decisions and form plans that enhance their economic goals as the social values satisfy at the same time. Also, the corporate goals must be a regular review to match the society changing expectation.

9. Conclusion

Due to the situation complexity, pronounced that just the law cannot assure corporate governance in a good state without principles of control and self-regulation. Regulations, laws and rules are wanted to coordinate the purposes of the numerous mutual interest gatherings. Furthermore, corporate governance aims to adhere to benefits, ethics of the work and to differentiate amid private funds and corporate funds.

Seeming the complexity of the situation, it is quite clear that law alone cannot guarantee good corporate governance without self-regulation and conduct codes. Rules, regulations and laws are needed to adjust the purposes of various interest groups of corporate. Still, the corporate governance goal is to adhere to work ethics, values and to distinguish between corporate funds and personal funds.

Practices of corporate governance are recorded to arrive at an aggregate number that can be used to verify the correlation with the financial performance of the Company. Classifications rely solely on practices related to the effectiveness of boards, the Board's regulations procedures, transparency and disclosure and several of these other parameters

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