# Chapter Two: Review of Literature

## 1.1. Corporate Governance - Definition

Corporate governance has been explained in different ways by different authors. However, in the current study, a common view has been drawn out of all these explanations. Some of these outlooks on corporate governance laid out by various scholars have been indicated below.

Milosevic et al., (2015) state that corporate governance is the act of driving, supervising, overseeing and controlling the activities of an organisation. These activities are administered by the board of directors. Furthermore, the board also plays the role of proxy advisors and they are the ones who connect with the other players within an organisation in order to get across the concept of organisational governance. According to Solomon (2020), corporate governance is a way to increase the responsibility and liability of the shareholders. Solomon (2020) also contends that the board must work towards a common goal- the growth and development of the organisation, and the corporate governance mechanism that is adopted must increase the liability of the shareholders. Furthermore, this mechanism should see to it that there is no mismatch while choosing the directors and auditors who will be instrumental in running the mechanism. In addition to this, the rights of the stakeholders and the rapport amongst them is indicated by the governance mechanism (Griffith, 2015). Also, the success or failure of the organisation is vastly dependent on the adopted mechanism.

According to Tricker and Tricker (2015), a more detailed definition of corporate governance was that it helps the board to achieve their ultimate goal. Here, the goal is to satisfy the needs and work towards the interest of various stakeholders such as the shareholders, creditors, suppliers and customers. Dignam and Galanis (2016) contends that the probable differences that might arise between the management and the stakeholders will be handled by corporate governance. Moreover, this mechanism also furnishes clear guidelines, rules and policies which support and administers the operations of an organisation. In this way, the structure, supervision and order of an organisation is defined by corporate governance.

The success of an organisation is majorly dependent on good governance. Furthermore, corporate governance is a collection of legal, cultural and institutional policies which determines the activities of a public corporation and its management structure. However, at a practitioner level, corporate governance has been explained in a different manner. In the Salami et al., (2014), corporate governance was considered as a mechanism where the management's interests are brought in line with the organisation's interests. This alignment is possible with the help of explicit governance and intelligible transparency in the process of governance. In addition to this, a strong standing system which guides and manages the organisation is referred to as corporate governance (the cadbury report, UK, 1992). Moreover, this definition also helps in interpreting how the efficiency levels of an organisation is dependent on the relationship between various stakeholders (CEO, management, shareholders, employees) of that organisation (Pargendler, 2016).

## 1.2. Theories of Corporate Governance

In the current-day research, a number of theories that can interpret the nature of corporate governance have been identified. Agency theory is one such theory proposed by Birch (2016). This theory contends that it is important to understand the role played by an agent within the organisation and it is further important to understand the relationship between the principal and the agent. When information used in the agency relationship is precise and unambiguous, the risk bearing costs and information related asymmetry can be minimised. The agency relationship stands on the precept of delegation where the principal assigns certain responsibilities to specific agents. Principal could mean one person in some cases and more than one in many other cases. Furthermore, such a relationship calls for both the parties to stay aligned with each other because, when the alignment gets disturbed, the governance activities get hampered.

Misalignment in this case can mean that the agents' needs are sacrificed due to difference in views between the principal and the agent (L'Huillier, 2014). In such situations, the activities of the agents could turn out to be more self-aligned, which can further impact the organisation's effectiveness. In order to reduce this issue, the governance mechanisms should support intense supervision and evaluation of agent activities (Bernacchio, 2015). However, the broader prospects of stakeholder interests are not considered by this theory, which acts as a limitation.

The second theory of corporate governance is the stewardship theory where the employment relationship between the principal and the steward in the absence of external agency costs is interpreted (Glinkowska and Kaczmarek, 2015). Here, the principal is the owner, and the steward is the manager. Furthermore, this relationship is interpreted in the behavioural and structural dimension. Moreover, the compatibility between the principal and the steward is analysed based on the alignment of their interests. Transparency in the firm's operational processes is a major determinant of this scenario of interest alignment (Madhani, 2017). When such an alignment takes place, the management would not require constant guidance and further they can be empowered to a certain extent to take decisions for the greater good of the organisation. The effectiveness of the organisation can be improved by adopting this approach (Keay, 2017). Nevertheless, one challenge to this approach is the capability of organisations to let go of external agency costs.

The institutional theory is the third approach to corporate governance. This theory studies the elements of social structures that depend on components such as value, routine, rules, judicial norms and regulatory systems. Consequently, these components that are attached to the regulatory systems and beliefs control the behaviour of stakeholders. Furthermore, according to this theory, the institutional regulation is impacted by various isoforms, which are coercive, mimetic and normative decisions (Kyere and Ausloos, 2020).

When the governments force the business authorities to develop a certain structure of policies and guidelines, it is referred to as coercive isomorphism (Martínez-Ferrero and García-Sánchez, 2017). As against this, when the corporate governance mechanism is developed by copying some best practices, it is called mimetic isomorphism (Martínez-Ferrero and García-Sánchez, 2017). Finally, when corporate governance develops on account of certain social/professional standards followed by an organisation, then it is called normative isomorphism (Teodoro, 2014). However, on a wider perspective, all these isomorphisms are limiting and confining in nature which will ultimately want all units within an organisation to hold similar behaviour patterns. Furthermore, internal controls within organisations are built with the assistance of the government or state authorities (Aguilera et al., 2018). Thus, such support from the government falls under the category of coercive isomorphism.

The stakeholder theory is a base employed to brainstorm on topics such as business ethics, strategic management, organisational effectiveness and corporate governance. In this approach, how the activities within the organisations impact such topics of discussion are analysed. According to Krenn (2016), stakeholders are defined as actors within the organisation who are primarily impacted by an organisation's level of achievement. Depending on the extent to which an organisation achieves its core purpose, stakeholders (group or individual) can be impacted positively or negatively (Lammers and Garcia, 2017). Thus, the main aim of stakeholder theory is to recognise the organisation's core purpose and to identify the accountability of the management to the stakeholders in achieving this purpose.

The corporate policies with respect to business operations and corporate responsibility are part of this theory. The management, employees of an organisation, the general public, the government, board members, and financial institutions are some of the stakeholders within an organisation. Furthermore, stakeholder accountability can be measured in this approach using two sources, which are managerial responsibilities and the ethical responsibilities (Boxenbaum and Jonsson, 2017).

## 1.3. Importance of Corporate Governance to Business Performance

In large modern organisations, the ownership and control are distributed when the property rights are held in the hands of different people and not by one person. Such an act helps in apportioning risk liability in terms of decision-making power and a specialised management benefits from this move (Bhagat and Bolton, 2019). Moreover, such an act gives the managers an opportunity to carry out their operations in an unrestricted manner which further helps them to seek their personal goals. However, this brings up a possibility of conflicts of interest between the shareholders and management (Naciti, 2019). Not only that, but an air of disagreement might also occur amongst various owners leading to clashes between them. There is a high possibility of such clashes when a majority owner in the organisation is not willing to share decision-making power and wants to single handedly have a hold on it (Paniagua et al., 2018).

To avoid such conflicts, corporate governance supports an equal and just participation of all shareholders within the company in the process of decision-making. In general, such shareholders form the company’s board of directors and such a board is expected to work jointly towards the interest of the company (Paniagua et al., 2018). This kind of corporate governance consists of elements such as: transparency in the company’s financial condition and ownership structure, unification of the board while taking decisions; and sharing profits among shareholders in an unprejudiced manner (Singh et al., 2018).

The four models of corporate governance are: the Anglo-Saxon, German, French, and Scandinavian models. The basic elements of corporate governance studied earlier becomes a part of all these four models. However, these elements lay down only the basic guidelines which can support a company’s growth and development. It is the cultural specifics that impacts the real design and application of these elements (Hartjes, 2020).

## 1.4. Research Framework

The governance structure supported and followed by organisations in theis perceived to be beneficial in many ways. This governance structure is characterised by transparency and it builds the confidence to handle authority in the right sense. Firstly, the transparency in the financial front benefits the funders and the investors, as it gives them the required assurance and notify them that their money is being utilised for the right purpose (Jacoby et al., 2019). This way, the investors can hope for good returns and can also reduce the risk and ambiguity associated with investments. Moreover, with strict standards that are developed via sound organisational design, right allocation of authority, and comprehensive policies and procedures, the success and prosperity of NOC is protected (López-Arceiz et al., 2018). Furthermore, NOCs set a certain standard for governance that all companies, be it public or private, can consider as a reference point while developing their governance structure and work towards reaching such a standard.

Various aspects of an organisation are considered while developing a governance structure. Such a structure not only considers working on the main purpose of the organisation but also, acts upon developing standards for policies and procedures (Aman et al., 2021). Moreover, in order to attain proper governance and control, even the support mechanisms must be thought-out and aligned to the main purpose. Organisational structure, reporting lines, outlining roles and responsibilities, risk management techniques and procedures for compliance management are some such support mechanisms (Zuber et al., 2017).

## 1.5. References


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