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Corporate Governance and Company: A Look into the Current State of Corporate Governance and its Influences

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Introduction to Corporate Governance

The concept of Corporate Governance continues to attract huge public attention across the globe. The discourses of good and responsible governance within the domains of corporate realm has continued for decades in the absence of specific codified provisions. In order to enhance their reputational and fiscal values, corporate entities around the world have voluntarily embraced the systems of good Corporate Governance. In the progression, more and more people started acknowledging that Corporate Governance was central to operative market discipline.

However, the notion of Corporate Governance is defined in numerous ways, since it possibly armors the whole range of activities partaking direct or indirect stimulus on the financial wellbeing of the corporate bodies. Consequently, different experts have come up with dissimilar descriptions of Corporate Governance, which principally replicate their distinctive interests in the said turf of ascendency.

Let us evoke the earliest narrative of Corporate Governance by the Economist and Noble laureate Milton Friedman. According to him, Corporate Governance is to conduct the business in accordance with owner or shareholders' desires, which generally will be to make as much money as possible, while conforming to the basic rules of the society embodied in law and local customs. This definition is founded on the economic perception of market value maximization that reinforces shareholder capitalism. Ostensibly, in the modern day milieu, Friedman's definition is narrower and orthodox in scope. Today, this definition may not hold as good as it might have in the earlier days. Nowadays, Corporate Governance comprehends the interests of not only the shareholders but also the whole range of stakeholders and workers as well.

Experts of the OECD have defined corporate governance as the system by which business corporations are directed and controlled. According to them 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 provides the structure through which the company objectives are set, and also provides the means of attaining those objectives and monitoring performance.

Governance, this word is derived from the word Gubernare, means to rule or steer. Initially it was meant to be a normative structure for implementation of authority or supremacy and recognition of accountability thereof in the running of kingdoms, regions and towns; though with the passage of time, it has found noteworthy bearing in the corporate domain.

The seeds of modern Corporate Governance were sown by various business scams and corporate failures all around the globe. Recent history is beleaguered with high profile instances of corporate frauds, mismanagement, oppression, embezzlements and corruption. The measure and rate of recurrence of these harms have ensued in a loss of buoyancy and confidence in the investment security and financial integrity of some of the world's largest financial markets. The corporate legislation has been found to be insufficient and retrograde.

Corporate governance has grown in importance not only among policy makers but also among professional associations who have increased their self-regulation. As a result of high profile corporate failures which affect the broader economy and society, corporate governance is now an everyday topic (Isaksson, 2017).

Corporate Governance is no more a way of control or management but it has evolved as a multi-facet organizational discipline. In fact, we would not even hesitate to brand it as a new science, which has to have triumvirate objective of making wealth, sharing wealth and accomplishing societal objectives. To achieve this troika, it is imperative to focus on the investor protection, professional management, prominence of stakeholders and corporate social responsibility.

Access to capital is essential to the production of goods, along with labor, management and "intermediary goods and services". "This is particularly true for equity financing which allows companies to increase their exposure risks that are associated with long-term and forward-looking undertakings such as the opening up of new business lines, corporate restructuring, research activities, product development and market expansion"(Isakkson, 1999).

The allocation of funding among various investments, as well as the effectiveness the use of funds, are essential factors in the investment process. There are three stages in the investment process: 1) mobilize capital; 2) allocate capital; and 3) monitor use of invested capital. The results of investments are dependent on "the institutional framework of laws, regulations and business practices that shape and affect the interactions between equity investors and the corporation", or corporate governance. The first stage (Mobilization stage) to developing such a framework involves the enforcement of property protections, including a method by which to register property ownership and the ability to seek legal relief if one's property is subject to harm or theft. In the second stage (Allocation stage), proper disclosure of corporate affairs and finances must be established to enable investors to make sound decisions about their investments. In the third stage (Monitoring stage), corporate decision-making procedures, distribution of authority, "operative incentive schemes" and accountability are put in place to ensure that investments are being used effectively and efficiently (Isaksson, 1999).

As set forth above, corporate governance is the backbone of sound investing. "A weak corporate governance framework will severely impede all stages of the investment process and hence the economy's overall prospects to build a strong private sector basis for economic growth. Poor corporate governance will damage the capacity to mobilise savings, it will hinder efficient allocation of financial resources, and it will prevent proper monitoring of corporate assets"

(Isakkson, 1999).

Several significant developments have contributed to the rise of corporate governance including the growing role of the private sector, an increase in globalism and new kinds of competition for companies. “The business corporation has become an increasingly important vehicle for wealth creation worldwide.” Corporations are crucial to job creation, generation of tax income, provide goods and services and serve as a platform for investment and savings. Thus, sound corporate governance is essential to maintain efficiency, public trust, and accountability. Good corporate governance not only increases shareholder wealth and company success but also serves the private equity markets, increases investor responsibility and corporate liability to all stakeholders by protecting financial institutions and enhancing the economy and society as a whole (Isaksson, 1999).

Growing international interdependence has also fueled the need for corporate governance regulations. In order for a corporation to secure international investment, both sides must feel confident. “Ambitions to ripe the full benefits of these new opportunities have triggered a need among investors and corporations alike to better understand different business cultures and corporate governance arrangements…they need to appreciate, and have well founded confidence, in the rules of the game” (Isaksson, 1999).

With labor and capital becoming less tangible, new challenges arise for corporate governance as firms evolve to suit modern realities, including the difficulty of presenting potential (and intangible) value to investors. There are also issues of talent recruitment and retention. “If a country’s framework doesn’t enable such adaptability at the company level, it will most probably impede the emergence of new industries and business opportunities that are not well served by more traditional arrangements” (Isaksson, 1999).

For us to understand the importance of corporate governance, it is essential to examine the origin of the concept and establish a definition. Some governments and institutions have addressed corporate governance in an attempt to provide guidelines for best practices as well as proper laws and regulations. The British Cadbury Committee was formulated in 1991 to address the “perceived low level of confidence both in financial reporting and in the ability of auditors to provide the safeguards which the users of company reports sought and expected.” This breach of confidence was due to a lack of accounting standards, too little oversight by directors and the failure of auditors to correctly report financial conditions. In its report, the Cadbury Committee defines corporate governance as “the system by which companies are directed and controlled.” It assigns company governance to the board of directors, whose responsibilities include determining and implementing company strategy and goals, monitoring of managers and accountability to the shareholders. The shareholder, in turn, is responsible for “[appointing] the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place” (Cadbury, 1992).

Like Cadbury Report, the International Finance Committee’s (IFC) definition of corporate governance is also the means by which corporations are “directed and controlled”. The IFC expands on its definition, explain that good governance “helps companies operate more efficiently, improve access to capital, mitigate risk and safeguard against mismanagement. It makes companies more accountable and transparent to investors and gives them the tools to respond to stakeholder concerns." Good corporate governance promotes more investment, access to capital and ultimately economic growth and development (ifc.org).

In this paper, we will focus on the concept of corporate governance as set forth by the Organisation for Economic Co-operation and Development (OECD). According to the OECD, corporate governance "involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined" (OECD, 2015).

The OECD Principles of Corporate Governance were developed to "help policymakers evaluate and improve the legal, regulatory, and institutional framework for corporate governance, with a view to support economic efficiency, sustainable growth and financial stability" (OECD, 2015).

There are five main principles, the first of which involves preserving the rights of shareholders. It states that "[t]he corporate governance framework should protect and facilitate the exercise of shareholders' rights and 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" (OECD, 2015).

The second principle addresses issues that may arise from intermediaries such as institutional investors or markets. "The corporate governance framework should provide sound incentives throughout the investment chain and provide for stock markets to function in a way that contributes to good corporate governance" (OECD, 2015).

The third principle seeks to recognize stakeholder rights "and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises" (OECD, 2015).

The fourth principle concerns disclosure and transparency issues, declaring that corporate governance framework "should 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" (OECD, 2015).

Last, the fifth principle sets forth the responsibility of the board to provide strategic guidance, oversight of management and accountability to shareholders and to the company itself (OECD, 2015).

The consensus, however, is that good corporate governance resolves conflicts between shareholders, management, and stakeholders; protects the long-term interests of the company; maximizes efficiency and performance; provides accountability to shareholders.

Methods of Corporate Governance

In OECD countries , there are two approaches to corporate governance, the “Outsider approach” and the “Insider approach.” The Outsider approach or “Market-based model” has its origin in “well-developed and highly liquid equity markets [and] relies heavily on the capital market as a means of evaluating performance and influencing corporate behavior.” The regulatory framework for “outsider” countries centers around disclosure and equal access to information which entails the open and widespread dissemination of corporate information into the marketplace with the regulation of exclusive information through insider trading laws. Securities regulations and stock exchanges are important for standards and compliance. In countries where equity markets are less important, banks serve as regulators and confidentiality rules prevent the dissemination of insider information (Isaksson, 1999).

Outsider markets recognize the shareholder as their ultimate beneficiary. “Outside investors” are uninvolved with corporate governance as their financial investment is their only real link to the firm. In this scenario, management has greater power over corporate decisions, including board selection. “The negative effects that may follow from this separation of ownership and from control has been at the centre of the corporate governance discussion in market-based systems.” On the other hand, increasing investments by institutional investors has resulted in concentrated ownership (Isaksson, 1999). We will elaborate on the role of individual shareholders and institutional investors later in this paper.

In less developed equity markets or "Insider markets", company ownership is often closely held by a few insiders who may also serve as board members and managers. This type of ownership structure can lead to less transparency, rigging against minority shareholders and abuses by majority shareholders. "Such abuse can take many different forms, and in the absence of strong disclosure requirements and transport accounts, the mere risk of such practices has often deterred minority participation." In some OECD countries, banks serve as creditors and majority shareholders. This gives them increased insight and influence over corporate governance which can create a conflict of interest between bank and equity shareholders when it comes to governance decisions. "Complex ownership structures, personal links and limited exposure to capital market influences have also raised concern that the insider approach impedes the ability to formulate, pursue and evaluate clear corporate objectives." In insider markets, the legal framework may or may not be strong which may determine how much insider abuse takes place (Isaksson, 1999).

There have been initiatives to improve corporate governance in both insider and outsider countries. For insider countries, the prescription is to "reconcile the strengths of traditional governance practices with the recognized economic advantages that stem from corporate access to equity markets." Outsider countries must "overcome the incentive and collective action problems related to dispersed ownership by promoting shareholder visibility and participation." Widespread ownership results in owners having little control over management. The stock market may serve as a correcting mechanism since management has an incentive to keep the stock price high to avoid takeover (Isaksson, 1999).

The 1980's saw legislation to avoid unwanted takeovers known as "poison pills", "shark repellants", "golden parachutes" (all methods of protecting managers) which faced strong opposition by shareholders, including institutional investors. "The main tool to achieve [a shareholder-friendly approach] has been to identify a set of governance safeguards, which are assumed to minimize the risk of abuse, waste, and moral hazard, and then request all portfolio companies to comply with these pre-established standards." In the outsider model, shareholders can use the board to as a "surrogate" control mechanism and there is "a broad consensus that a more professional and independent board is a viable way to improve corporate governance" (Isaksson, 1999).

There are also specific tools used to address the collective action problem. In the United States' Securities and Exchange Commission ("SEC") which is used to mitigate issues of dispersed ownership and collective action by facilitating communication between shareholders and corporations and promoting oversight. In the United Kingdom, "relational investing" allows institutional investors to engage in "direct and informal discussions" with the board and management. Market-oriented countries have used intermediary owners to "pool capital from various sources in order to acquire large ownership stakes in a limited number of companies" to solve the problem of collective action (Isaksson, 1999).

In insider models, the primary issues are protecting minority shareholders, transparency and widespread access to financial information. The German Act on Control and

Transparency has increased shareholder rights, transparency, and audit quality as well as introduced shareholder voting caps. The French corporate sector cut down on cross-shareholdings and increased oversight. Bank influence is also regulated so they must be more accountable to their customers. Some banks are even shifting away from corporate holdings to focus on their bottom line. Other methods of facilitating shareholder participation are by proxy voting, changing, compensation schemes, establishing national corporate governance guidelines, and promoting co-operation agreements between stock exchanges (Isaksson, 1999).

In summary, good corporate governance promotes transparency, shareholder participation, protection for minority shareholder and quality firm information. Policy makers and self-regulatory bodies must create a framework. "In this process, the presence of competent authorities that effectively can monitor compliance with existing rules has proven to be a critical factor if well-intended initiatives are to become more than hollow aspirations." Insider and outsider models are not mutually exclusive and companies may adopt one or the other depending on the needs of the corporation. In fact, businesses may even change their model of corporate governance as they evolve (Isaksson, 1999).

Investors may either take an "arm's length" approach to investment strategy, "[relying] on pre-established governance standards to minimise risk" or a "hand's on" approach "characterised by customised governance arrangements in combination with transparency and full contractual clarity." Some investors will choose to use a combination of the two (Isaksson, 1999).

The Investors

Now that we have established what corporate governance is and why it is important, we will look at the role investors play in corporate governance. The "Long-Short Theory" of investment identifies two types of investors: short-term and long-term. The theory purports that short-term investors push corporate managers to invest in short-term policies for temporary increases in stock price. In turn, "short-termism requires new regulation or new liability to curb shareholders that 'push for corporate strategies that they believe will temporarily inflate stock prices'". Hedge funds have a short-term perspective, caring only about the short-term price of the stock. Once the stock is sold, they have no interest in its value. Therefore, these institutions pressure managers to adopt policies to produce a short-term bump in stock value, taking the focus away from what may be good for the company in the long-term. Commentators and judges have agreed with the need for regulation to prevent "short-termism" from causing significant disruptions in the market and broader economy (Anderson, 2015).

There are fundamental problems, however, with the reasoning that short-term investors will cause long-term harm to corporations. It assumes that market actors will dump the stock after the initial bump, producing "unsustainable" differences in short-term and long-term stock values (also known as "Financial Market Theory"). The argument also rests on the belief that short-term and long-term investors have conflicting values. Since corporate law treats all shareholders the same, the notion that there are two distinct types of shareholders would result in conflicts of interests between shareholders. “Since managers are usually shareholders, they too would have conflicts with other shareholders that would arise in virtually every corporate decision” (Anderson, 2105).

The Principal-agent model “posits that the suppliers of financial capital (shareholders) hire managers of the firm (officers and directors) to carry on a business.” The manager’s job is to maximize profits and, although they are given a small amount of equity as an incentive, it is not enough to dissuade them from acting in their interests. A shareholder franchise can be a means of supervising management. They are given voting powers as “residual claimants” who thus have the most incentive to increase the bottom line. Most shareholders, however, are passive investors, creating a collective action problem which is solved by the aggregation of share. This is subject, however, to a hostile takeover situation for underperforming companies giving managers more incentive to ensure that their business is performing well. In the 1980’s and 1990’s, as hostile takeovers disappeared due to new laws, institutional shareholders became the new solution to company performance, managerial accountability and the free-rider problem (to a certain extent) (Anderson, 2015).

Because the Long-Short model sees shareholders as having different motivations, there is no “champion for the shareholders as a whole” or rejection of the “principal”. The Long-Short model is based on the assumption that there is “deep conflict” between shareholders sin qua, who prefer different governance policies and “they are in conflict most of the time.” Institutional investors, however, can have long-term (pension funds) and short-term (hedge fund) characteristics. Hedge funds have been criticized for focusing on short-term gain over “long-term wealth creation.” Additionally, Long-Short theorists have varying ideas of what constitutes a “short-term” shareholder (Anderson, 2015).

Short-term investors may also push for policies that could hurt long-term shareholders, assuming such policies exist. Examples of short-term policies include dividends and share repurchases. Managers cooperate with the short-termers because they fear losing their position. “The entire argument, therefore, turns on the questions of whether the markets are myopic in systematic, predictable ways that allow short-term shareholders to reap benefits at the expense of long-term shareholders” (Anderson, 2015).

Long-Short theory is based on claims that short-term and long-term stock prices differ; that these differences are predictable to short-term investors to the extent that they push policies that inflate stock prices; and without pressure form short-term investors, managers would favor policies that would help the corporation long-term. These claims are not reliable because if short-term stock prices were always higher than long-term prices, the discrepancy could be anticipated and corrected. Also, there would have to be long-term investors willing to buy the stock from the short-term investors at a higher cost. “The most elementary financial economics would suggest that ‘[i]f a governance provision does not serve long-term shareholder value, its adoption will likely reduce short-term prices (which reflect expectations about short-term value’” (Anderson, 2105)

Markets are efficient and stock prices (ideally) reflect all available information. In reality, "prices reflect information to the point where the marginal benefits of acting on information (the profits to be made) do not exceed the marginal costs." The market must be inefficient for short-term and long-term prices to be different, which is the claim made by Long-Short theorists. Inefficiency in the market can be explained by "Arbitrage theory" which states that anomalies result from miscalculations of different types of actors. Arbitrage is risky and is therefore limited to a highly trained few that would act on anomalies. In that regard, arbitrage is extremely limited and inefficiency is unpredictable. Long-Short theorists can't explain "the specific mechanism by which stock prices will differ in the short-term from those in the long-term. Instead, the assumption is simply that market inefficiency leads automatically to short investment horizons dictating short-term behavior" (Anderson, 2015).

The implications for corporate governance lie in the efficiency of markets. If markets are inefficient, we must know how they are inefficient to make recommendations to governance. Also, if we knew what caused inefficiencies, the stock price would reflect that. "[Policies favored by activists to increase short-term share price] typically include increasing dividends, increasing leverage, increasing risk, and decreasing expenditures on research and development. They do not, however, point to systemic, well-established empirical evidence that these policies or institutional ownership, in general, is harmful to shareholder wealth. Nor could they, as such evidence shoes not exist, and indeed the empirical evidence is to the contrary." Managers will not put off long-term projects for short-term gains out of fear of the share price dropping. The short-term managerial focus may lead to overinvestment or underinvestment in long-term programs. "[M]anagers should use an optimal operational horizon, discounting longer-term payoffs to present value to make positive net-present-value investment decisions." Long-term only value can actually drive up short-term prices (Anderson, 2015).

The Board

Another factor in corporate governance is the Board of Directors. The Board of Directors ("board") is the principal instrument through which shareholders may have oversight over management. Existing literature has defined three primary functions of the board: to monitor management, to oversee strategy, and to provide expertise and connections (Madhani, 2017).

From the governance perspective, there are four major roles of the board: 1) to monitor firm operations and management ("Control Role" or "Agency theory"); 2) to assist and guide management in fulfilling the corporate mission through advice and strategy ("Strategic Role" or "Stewardship theory"); 3) to provide "access to networks and resources" and maintain relationships with stakeholders ("Service/Resource Provision Role" or "Resource Dependency theory"); and 4) to advise the Chief Executive Officer in ways that the insiders cannot ("Advice and Counsel Role") (Madhani, 2017).

Agency theory defines the relationship between the principal (shareholders) and agent (managers) as a contract between the two parties. Shareholders elect the board who hires corporate managers. This theory assumes there is a conflict of interest between shareholders and managers which must be resolved through corporate governance. "On minimizing the agency conflict between the owners and managers and aligning their interests, the firm should function more efficiently, resulting in enhanced financial performance." Agency theory also assumes managers will use their knowledge and position to gain an advantage over shareholders for their own benefit. Shareholders with limited interests do not have huge incentive to monitor managers. Under this theory, the board is responsible for monitoring management on behalf of shareholders "serving to alleviate or reduce the problems associated with the separation of ownership and control in firms." Agency theory favors a board composed of independent directors who can oversee management. Prior research shows "that the presence of independent directors on boards of firms actually improves governance of those firms." There should also be a distance between Chairman of the Board and the Chief Operating Officer ("CEO"), also known as "CEO duality" (Madhani, 2017). Research has shown that "CEO duality weakens the relationship between poorer prior performance and attention to monitoring. Additionally, CEO duality is also negatively related to the strategic involvement of the board" (Garcia-Torea et al., 2016).

While it does explain a key function of the board, Agency theory does not consider the importance of other board roles. Stewardship theory, alternatively, downplays the importance of monitoring and relies on trust between shareholders and management. This perceived or actual trust "minimizes the costs of monitoring and controlling the behavior of management." For these reasons, Stewardship theory promotes CEO duality. "The CEO duality creates a harmony between the board, managers, and shareholders which is more efficient and effective in order to reach the goals of organizations." This is solely based on the assumption that managers can be trusted and inside directors have the incentive to work in favor of shareholder interests. Costs are further minimized in that inside directors have direct knowledge of firm operations. Stewardship theory does not consider that managers may not always act in shareholder interest (Madhani, 2017).

Resource Dependence theory centers on the role of the board in facilitating external connections. "The key role of the board is its ability to link to significant resources" to increase firm performance. The board essentially acts as a resource in providing access to networks or "interdependencies" resulting from the need for external resources. "Resource dependency theory proposes that corporate boards are a mechanism for managing external dependencies, reducing environmental uncertainty and reducing the transaction costs associated with environmental interdependency." This theory favors board composed of outside directors who can provide expertise and advice, create communication lines to external organizations, assist in gaining support from outside agencies and individuals and give legitimacy to the company (Madhani, 2017).

Resource-Based View theory rests on the idea that the firm is comprised of tangible and intangible resources. "A firm's resources can be the basis of sustained competitive advantage is the resources are valuable, rare, imperfectly imitable, and not substitutable." This concept can be compared to board composition in that the inherent knowledge and experience of board members can contribute to a firm's success by creating an advantage over other firms. This is especially true when the board is involved in strategy and decision making. “Outside directors have a greater breadth of knowledge and experience” than insiders. Each director brings his or her own “unique attributes” and board serves as a resource for the firm and can create dynamism and adaptability to changing needs (Madhani, 2017).

At play in the various theories is the concept of social capital. “[S]ocial capital entails advantages that individual or collective actors have because of their location in the social network structure”. It can provide people with access to information, influence over others, and create trust and solidarity and reinforce norms. There are two types of social structures: network closure and structural holes. Network closure is achieved when “all actors in the network are connected with each other”, creating obligations, expectations and trustworthiness, facilitating the exchange of information and providing accountability through sanctions. Structural holes “provides a relationship of non-redundancy between two contacts.” Actors who can bridge the hole serve as brokers and can use the hole to “become an opinion leader” and to control the relationship between the two networks (Niu and Chen, 2017).

Agency is a problem because of the separation between shareholders and control over the management of a corporation. Boards can be used to mitigate this issue through oversight. The OECD Principles state that “[t]he board is chiefly responsible for monitoring managerial performance and achieving an adequate return for shareholders while preventing conflicts of interest and balancing competing demands on the corporation” and “to oversee the risk management system and systems designed to ensure that the corporation obeys applicable laws.” In that regard, the board must be independent and objective. Specific laws and regulations have been put in place requiring that boards must have a certain proportion of independent directors to ensure diversity and oversight. Some examples of these are the Sarbanes-Oxley Act, Cadbury Code (as previously mentioned), Hong Kong’s 2012 Code of Corporate Governance Practices, and the Singapore Code on Corporate Governance (Niu and Chen, 2017).

A director’s social capital can affect his behavior, the board’s performance, and corporate governance as well as the potential normative implications of the director’s social network. In a study of social capital and corporate governance, the authors found that board performance is high when the directors have more social capital (Niu and Chen, 2017).

The authors pose social connections of directors create inequality of social capital on the board. Social ties between directors may create “inequality of social capital among them [and] differentiation of empowerment may help to undermine the negative effect of social ties between managerial and independent directors.” Social capital gives power to directors and influences corporate governance and decision making. Structures of network closure and structural holes provide social capital which may, in turn, improve board performance (Niu and Chen, 2017).

The authors also found that social capital of board members should contribute to their board performance more than executive director’s social capital. Independent directors must limit their ties to management to maintain objectiveness. There is inequality of social capital within networks. The person with most connections within the network has highest social capital. “In a board setting, the variations in the network positions of different directors represent the different levels of social capital they hold. The inequality of the social capital of directors may influence their decision making. Directors with more social capital can increase other directors’ dependence on them and decrease others’ willingness to lose contact with them. If on a board, the managerial director holds a better position in the network than the independent director, it may be reasonable to assume that the independent director would be unlikely to risk dissenting with the managerial director” (Niu and Chen, 2017).

Social capital cannot be “required” to any certain degree but may “complement existing corporate governance regimes” by providing a tool for board selection. Additionally, social capital may be used as a tool to predict firm value and may allow regulators or exchanges “to better perform their market surveillance function with more precise data on the board of directors of a company” (Niu and Chen, 2017).

Effective board composition is contextual, varying depending on the specific needs of a company. While there is no universal recommendation for board composition, however, board expertise, like social capital, plays a role in corporate governance. In this study, firm value is associated with a good fit between quality management strategy and board composition. The authors define two categories of board expertise: firm-specific knowledge and general expertise. Firm-specific knowledge is brought to the board by inside directors who have insider information and understanding of firm strategy. Their involvement in quality management decisions increases managerial commitment. General expertise, on the other hand, is necessary to enable directors to make significant contributions to strategy. Expertise related to specific needs of the company (financial, legal, industry-specific) can enhance complexity and competitive advantage. Industry expertise and management expertise are particular to quality management. Further, management expertise can boost efficiency and quality (Charitou et al., 2016) Additional research shows that “directors should have functional and firm-specific experience and skills to increase boards effectiveness.” Shareholder value increases as markets react positively to companies whose directors are experts (Garcia-Torea et al., 2016).

The study shows a positive relationship between many board members with inside and outside expertise and quality, specifically outside directors with a Ph.D. in the firm’s central objective increase capability and competitive advantage and play a significant role in strategy and decision making. “Outside directors with recent expertise in related industries are able to provide industry insights from the industry the company operates in, or from upstream/downstream industries, including a deep understanding of the risk and opportunity profiles of the related industries.” These outside directors also have social capital as they may provide access and connections to other related industries. Directors with outside expertise may also “enhance the firm’s ability to handle complexity” and thus may be found on boards of companies with more complexity. This study also found that inside directors and directors with management expertise are not associated with the likelihood of successful quality management (Charitou et al., 2016).

In addition to social capital and board expertise, research has shown that board size and

Large boards are not as effective as small boards, which encourage "participation, involvement, and cohesiveness." Increased frequency of board meetings and the establishment of monitoring and performance committees also improve board effectiveness. Last, the presence of women on a board leads to better financial performance as women are more present at board meetings and more active in monitoring. Women are also more likely than men to consider alternative perspectives and strategies (Garcia-Torea at al., 2016).

The Stakeholders

Aside from board composition, there are other means of assuring investor confidence. The OECD emphasizes stakeholder rights as a necessary component of good corporate governance. Stakeholder rights differ from shareholder rights in that while stakeholders may not have an actual ownership interest in the company, they have any interest in the company performance as well as social and environmental impact. In other words, stakeholder perspective is linked to corporate social responsibility (CSR). "CSR aims to maximize '…the creation of shared value for their owners/shareholders and for their other stakeholders and society at large'" (Garcia-Torea et al., 2016). Renewed interest in corporate responsibility and demands for CSR reporting has created pressure on corporations to respond. As social concerns about the activities of firms grow, social responsibility has been incorporated as a part of corporate governance While companies do take some action to improve CSR, often they are only symbolic gestures and do not address the underlying cause of the problem in their corporate governance (Klettner et al., 2014).

In addition to social concerns, there is a growing acceptance that corporate sustainability can actually add value to firms. This is fueled by "enlightened shareholder approach" which is more of stakeholder-oriented approach to corporate governance. "[O]rganisations must try to achieve their own objectives (e.g. profitability) while at the same time satisfying in a fair way the legitimate claims of their stakeholders" (Klettner et al., 2014).

CSR laws vary from country to country depending on social traditions. International standards, however, are becoming more important, providing "broad principles and reporting frameworks but leave it up to the companies to decide how to implement these principles." The International Labour Organisation Declarations, the OECD Guidelines, and the United Nations Global Compact establish standards, principles and specific recommendations on CSR. "Research provides empirical evidence of developing norms in the area of corporate sustainability and the influence of international soft law on corporate behavior." CSR procedures allow businesses to consider all stakeholder interests but require commitment at the corporate level. CSR can be valuable to business and "good practice" is influenced by government regulations, stakeholder pressure, and even negative publicity. As CSR is a crucial part of long-term strategy and legitimacy, environmental, social and governance factors must be considered as part of business performance instead of an “externalities” (Klettner et al., 2014).

Research has also shown that investment decisions are directly affected by CSR performance, precluding strong governance as a factor. Firms are increasingly issuing CSR performance disclosures, which “shed light on multiple aspects of a firm’s value proposition.” CSR performance disclosures also increase the credibility of firms and affect share price. “Firm’s with strong CSR performance have greater potential to increase shareholder value as well as the value of other stakeholders.” Strong corporate governance and high levels of CSR are not mutually exclusive, but complementary. Firms with stronger corporate governance tend to be engaged in more CSR activities. Assurance of CSR information increases its value to investors and corporate governance may affect the influence of CSR information. A firm with a low level of CSR can face bad publicity, which may decrease its value while a high level of CSR can increase customer loyalty (Klettner et al., 2014).

Investment decisions are linked to CSR policies (especially when those policies are made widely known) and by governance strength when CSR performance is high. “This lends support to an attributions theory explanation in that positive news about a company is discounted unless an investor has some sense that the disclosure is reliable. This suggests that without some signal of the reliability of information, investors may be wary of the veracity of positive CSR disclosures” (Cohen et al., 2017)

In short, corporate social responsibility adds value to firms (in credibility and share price) by creating a positive image through accountability to all stakeholders. When positive CSR disclosures are widely disseminated (and can be considered credible), investors are confident and more likely to invest.

Corporate governance is arguably the single most important factor in attracting private investment. It is multi-faceted and influenced by governments, economic structures, directors and management, stakeholders and even investors. There are a multitude of factors that may determine whether a corporate governance system is “good” or “bad”. It is clear, however, that a failure to establish an appropriate corporate governance framework can not only be detrimental to a company, but to a society as well.