Impact of Corporate Governance on Firm Performance

Ms. Jasmeet Kaur

INTRODUCTION

Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. It provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

Corporate scandals like Enron, Worldcom etc. have led to the emergence of corporate governance measures in order to safeguard the interests of stakeholders of a concern. These measures encourage investor confidence and financial market stability. It has been known that in developed countries like USA, corporate governance laws were introduced way back in the year 2002 with the Sarbanes Oxley Act. The Indian economy however, has been a late mover with regard to these measures but the pace at which the implementation work is being carried off is phenomenal.

Good corporate governance principles are transparency, accountability, responsibility, independence, and fairness. The practice of corporate governance is strongly influenced by the parties involved in the management system of a company such as shareholders, investors, creditors, employees, and government. Good corporate governance is expected to increase firm performance. The main objective of the implementation of good corporate governance is to optimize value for shareholders and stakeholders in the long run. Corporate governance has assumed a central place in the continued effort to sanitize corporate reporting and shore up public confidence in financial markets around the world.

Effective CG requires the installation of mechanisms to ensure that company executives respect the rights and interests of the stakeholders, and to act responsibly with regard to the generation, protection, and distribution of wealth invested in the firm. Good CG contributes to sustainable economic development by enhancing the firm performance and increasing their access to outside capital.

Corporate governance is a multifaceted concept which has attracted multiple understanding and interpretations, accordingly, no generally single acceptable definition of corporate governance. Different authors have explained corporate governance differently and associate it with quite a range of corporate issues. Their explanations surround agency relationship and link between corporate governance and the governance of the corporations, paying little attention on the shareholders' interests.

Therefore, corporate governance continues to be a focus of research due to its perceived role and contribution to the firm's performance. There is extensive body of knowledge which explores the correlation between Corporate Governance and firm performance. This interest appears more appropriate at this time, when business executives and auditors are continually being held to higher standards of accountability and responsibility, even though corporate governance issues may be traced back to the nineteenth century with the advent of limited liability incorporation.

What is the relationship between CG and corporate performance? Does good CG impact profitability and value creation for companies? The answer to these questions may have important implications. This study aims to review and expand general understanding on the relationship between corporate governance and firm performance. The study is motivated by the current debate on the role of corporate governance on firm performance and sustainability and an assertion that corporate failure is a result of failures in corporate governance mechanisms.

Prior studies have confirmed notable roles played by corporate governance on firm performance. The study has analysed and comprehended key issues of corporate governance and key factors affecting its general mechanism in protecting shareholders' interest. It further analyses and presents key players of corporate governance which in one way or other have strong influence on the effectiveness of the corporate governance. The study adds on the existing debate and widens stock of literature relating to roles of corporate governance in maximising shareholders' value. It is considerably of usefulness to investors, practitioners and other stakeholders who are interested with firm's operations performance in particular. So this literature review survey is an effort to investigate the relationship between CG mechanisms and Firm Performance.

LITERATURE REVIEW

Board Structure and Corporate Governance

Board structure and its impact on corporate governance has been the subject of intense scrutiny both from academics and from regulators. Hence it is worthwhile to review some of the literature.