

Governance and performance: what relationships? State of the art

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Abstract:

Corporate governance is a subject that always comes back to the heart of debates and current events in the field of management; it has gained momentum following the crises experienced by the world from the 2000s, thus calling into question the robustness and quality of existing governance mechanisms. Initially, it focused on the relationship between managers and shareholders, thus favoring financial performance, then its field of study gradually widened to include other stakeholders and cover other dimensions related to overall performance. Several research works have been carried out in order to determine the existing correlation between governance and performance. Most of the empirical studies listed in this work confirm the existence of a positive link between these two quantities. That said, other studies question this causality and the alleged existing link.

Keywords : Corporate governance, performance, correlation, shareholders, board of director

Jel Classification Codes : G32, P27

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1. INTRODUCTION

In recent decades, notable corporate failures such as Enron in the USA, and France Télécom and Vivendi Universal in France, have underscored the weaknesses and inefficiencies in corporate governance systems. Consequently, the quality of corporate governance has emerged as a pivotal aspect evaluated by international rating agencies like Standard & Poor's, Moody's, and Fitch.

Today, there is a pressing need for more stringent corporate governance practices. It comprises organizational mechanisms aimed at defining and regulating powers to influence management decisions while safeguarding the rights and interests of shareholders and various stakeholders such as managers, customers, suppliers, and financial institutions. Corporate governance entails adopting a set of rules to ensure a balanced distribution of power. In an environment shaped by evolving stakeholder expectations, where transparency and accountability are increasingly demanded, understanding the impact of governance on financial and operational outcomes is essential for executives, investors, and the broader business community. Moreover, a growing body of research emphasizes the influence of governance on corporate performance, aiming to encourage and persuade companies to embrace this approach.

The question of the study:

What is the link between corporate governance and performance?

Hypothesis:

Governance contributes to improving performance but to varying degrees.

The Objectif of the study:

The main aim of this article is to identify the causal effect between good governance practices and corporate performance, by drawing on various academic research studies in this area, and to position our subject within a relevant theoretical framework.

The importance of the study:

The study of the causal effect between good governance practices and corporate performance is of paramount importance in the current context, marked by the adoption of good governance standards by a significant number of companies and the growing enthusiasm of investors for investment.

This research is doubly beneficial for companies and decision-makers, as it could encourage them to strengthen their governance mechanisms, especially those with a positive link to performance.

Methodology:

In order to answer our question, we conducted a bibliographical search, using various books, documents and university articles.

2. Definition of corporate governance

Although corporate governance is a very old concept, it is still difficult to define and pin down. It is treated differently by different authors, and there is no universal definition of the concept.

According to (SHLEIFER A. et VISHNY, 1997), corporate governance encompasses the means by which a company's capital providers can ensure the profitability of their investment. A definition which emphasizes the maximization of shareholder value.

(PEREZ, 2003, p. 22), for his part, provides a broader definition of corporate governance, which is conceived as : "the institutional and

behavioral arrangements governing relations between the managers of a company, or more broadly, of an organization, and the parties concerned by the future of the said organization, primarily those who hold "legitimate rights" over it. With this definition, the author emphasizes the existence of relationships between managers and various parties, notably shareholders, suppliers and customers....

According to (Gérard, 1997), "corporate governance covers all the organizational mechanisms which have the effect of delimiting the powers and influencing the decisions of managers, in other words, which govern their conduct and define their discretionary space". This definition focused on limiting the power of managers.

The Organization for Economic Co-operation and Development (OECD, 2004) gives a broad, consensual definition: "Corporate governance refers to the set of relationships between the management of a company, its board of directors, its shareholders and the various other stakeholders. Corporate governance also provides the framework within which the company's objectives are set and defines the means to achieve them and monitor performance".

This definition highlights the relationships between a company's management, its board of directors, its shareholders and other stakeholders. It also determines the structure by which a company's objectives are defined, and the means used to achieve them.

3. The different approaches to corporate governance

There are two main approaches to corporate governance, one focused on the shareholder-manager relationship, known as the shareholder model, which proposes an analysis based on an asset-

based view of the company. The other approach is the stakeholder model, which broadens this view by considering the relationships and interdependencies among all stakeholders.

3.1 Shareholder Approach or Shareholder Model

This model represents the oldest form of governance, according to (Caby, 2001) , this approach embodies a "traditional" concept that focuses on the interests of shareholders and adapts to the "managerial" society. It is the reference regulatory mode in Anglo-Saxon countries.

This approach finds its origin in the works of Berle and Means, considered the founding fathers of shareholder governance through their seminal work "The Modern Corporation and Private Property," which is regarded as the most cited text in contemporary literature on corporate governance (Gomez, 2009). Indeed, through their work, Berle and Means raised the issue of the separation between ownership and control at the level of the modern corporation. As a result, shareholders, owners of the share capital, cannot take over the day-to-day management of the firm and are obliged to appoint directors to ensure its direction and control. These directors, especially in the absence of careful control by shareholders, may mobilize the company's resources for their own interests at the expense of capital providers.

The financial model of governance generally relies more on the normative branch of agency theory. This model originates from the analysis of (JENSEN et MECKLING, 1976) , which further emphasizes the conflicts of interest between shareholders and managers, asserting that the firm is a nexus of contracts at the center

of which lies the shareholder/manager relationship, which is a source of agency conflicts when capital is dispersed, giving managers greater latitude.

According to this theory, shareholders are the best guarantors of good corporate governance, prioritizing the relationship between the manager (agent) and the shareholders (the principal). (Gomez, 2009) .

(Shleifer & Vishny, 1997) confirmed these claims by stating that corporate governance deals with the ways in which capital providers ensure a return on their investment.

Additionally, (Cappelletti & Khouatra, 2002) emphasize, according to financial theory, that corporate managers must act in accordance with the objective of maximizing shareholder wealth for value creation.

We can thus say that this approach is based on shareholder leadership. The main role of governance is to push managers to maximize shareholder value under the assumption that shareholders are the only remaining creditors of the company and that it is necessary for them to ensure that managers act in favor of increasing created value.

3.2 The partnership approach or the stakeholder model

The shareholder approach to governance has been and continues to be criticized. Among the criticisms levelled against it is that of (Gomez, 2009), who argues that this approach is "at the root of crises", insofar as it focuses solely on the interests of shareholders, ignoring those of other

stakeholders. What's more, the pursuit of shareholders' interests alone can be detrimental to the general interest that guarantees the company's long-term development. (Gomez, 2009)

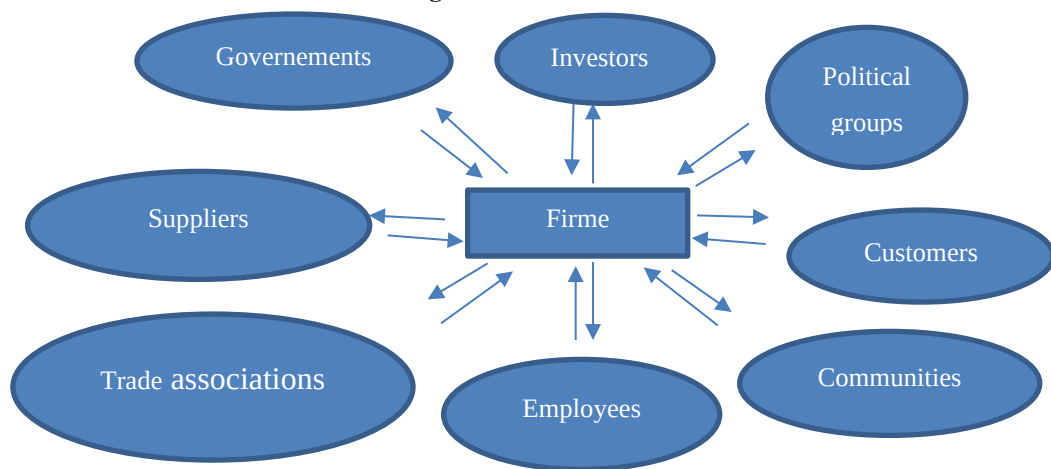
The partnership model has its origins in the theory of incomplete contracts, notably in the work of (Grossman & Hart, 1986) and (Hart & Moore, 1990). According to this vision, society is a set of multilateral contracts (bringing together different partners with different interests), whose synergies are the basis of value creation. In this approach, the company takes into account the participation of all stakeholders in the work of the organization, who, without exception, contribute to the process of creating and distributing value. The shareholder is no longer the only remaining creditor, so management is tasked with making decisions in the interests of the "stokholders". The company's stakeholders include all the internal and external players directly or indirectly affected by the various activities carried out within the company, such as suppliers, customers, employees, investors, the community, etc. **(See figure 1)** A company's performance is no longer considered in terms of its ability to generate profits and financial benefits for shareholders, but in terms of its ability to assume its social responsibilities.

In a context of optimizing social responsibility, corporate governance is no longer the responsibility of management alone, but of all stakeholders. In this case, the company is an entity in which cooperative and competitive interests diverge. Thus, interactions are optimized and accelerated to enable boundaries between the company and its engaging stakeholders (Cappelletti & Khouatra, 2002)

We can thus say that the partnership approach to governance presents

a revolutionary character insofar as it has challenged the foundations of the historically dominant financial approach. Thus, the very purpose of the company has been profoundly modified, moving from the pursuit of shareholder value maximization to the pursuit of partnership value enhancement, which ensures the general interest and ensures equitable sharing of created wealth. The involvement of new partners in the process of creating and distributing value has brought about a profound change in the roles of governance mechanisms, which are now responsible not only for maximizing partnership value but also for limiting value losses related to conflicts that may exist among the different stakeholders.

Figure 1: Stakeholders



Source : Adapted from Donaldson and Preston, 1995, p. 69 (extract from Mercier, 2001, p.4)

This figure highlights the partners and stakeholders that the company

must take into account when making decisions, such as governments, suppliers, customers, employees, investors, etc.

4. The link between governance and performance: empirical study results.

Multiple empirical studies have been undertaken to examine the correlation between corporate governance mechanisms and performance. These studies vary in methodologies and geographic focus, as well as in the range of indicators used to assess governance quality and performance. Despite this diversity, divergent findings have emerged, leaving the question of whether a relationship exists between corporate governance and performance unresolved.

The results of several studies conducted in this regard have been synthesized below, distinguishing between those establishing a correlation between corporate governance and performance and those questioning the existence of such a link.

4.1 Empirical studies showing a correlation between governance and performance.

Among the studies conducted on the relationship between corporate governance and performance, the majority of them have concluded that performance differences among companies are explained by differences in the governance mechanisms adopted (Mayer, 1996). Thus, significant importance has been given to these mechanisms to demonstrate their role in creating value for shareholders and other stakeholders.

In 2008, the Association of British Insurers (ABI) published research

showing that companies with the highest governance scores achieve a profitability 18% higher than those with the lowest governance scores.

Academic research has also confirmed the existing link between corporate governance and performance. (Black, 2001) tested this link on a sample of 21 large Russian companies. Although the sample size was relatively small, the results of the study showed a very significant correlation between the value of the companies studied and their governance quality. Additionally, (Black, Jang, & Kim, 2006) constructed a governance index for a sample of 515 Korean public companies using Tobin's Q. They observed a correlation between this index and the market value of the companies studied.

On their part, (Bauer et al, 2003) confirmed that governance was positively correlated with securities profitability and market values of companies but negatively correlated with their operational performance. The weakness of the governance relationship with operational performance can be explained by the discretionary power granted to managers in the preparation of accounting reports, given that better governance would reduce this discretionary power.

(Gruszczyński, 2006) tested the effect of governance on the performance of Polish companies. The results showed a significant association between the governance score used and the financial performance of these companies, their operating profit margin, and the debt ratio.

Also, (Kolsi & Ghorbel, 2011) studied the association between

governance mechanisms and financial and stock performance measures of 134 Canadian companies for the year 2007, through four governance mechanisms, namely, board composition, ownership and compensation, shareholder rights, and disclosure of information. The performance of these companies was evaluated through the following indicators: ROA, ROE, and Market-to-Book (MTB). The study highlighted the consistency of the model expressing the effect of governance on performance. Indeed, the results showed that a threshold relative to the disclosure index must be exceeded for governance to translate into a positive effect on financial performance. Transparency is thus essential for improving the financial performance of companies.

On their part, Bauer et al (2008) studied the association between governance quality and the performance of Japanese companies using data provided by Governance Metrics International. They developed a total index comprising six governance dimensions. It was shown that companies with the best governance had a performance superior to others by 15% per year.

(Mohamed, Basuony, & Badawi, 2013) focused on the impact of corporate governance on the financial and stock performance of 88 non-financial Egyptian companies. The governance mechanisms studied were three; ownership structure, board composition, and audit quality. Control variables were included in the analysis, such as size, age, sector, and financial structure of the company. Financial performance was evaluated in terms of ROE and ROA, and stock performance through Tobin's Q. According to this study, ownership structure and audit quality have no effect on the stock performance of companies in the sample studied; only board independence

positively impacts it. Additionally, the financial performance of the company is correlated with board independence and CEO duality. Company size and financial structure seem to have variable effects on the financial and stock performance of the company.

According to (Charreaux, 2000), board composition and size have a significant impact on performance. Indeed, external and independent directors are encouraged to monitor the manager to remedy legal actions by shareholders and protect their human capital. Also, according to studies by (Yermack, 1996) and (Dalton, Daily, Ellstrand, & Johnson, 1998) , the small size of the board has a significant impact on the performance of American companies.

(Denis, Denis D, & and Sarin, 1994) , found a positive relationship between the presence of significant shareholders and company performance. The presence of significant shareholders may impact manager activity control. However, (Loderer & Martin, 1993) claimed that effectiveness depends on the behavior and persuasion of major shareholders.

(Klein, 1998) through his examination of the composition of board sub-committees found a positive link between this and performance. The manager's participation in company ownership could reduce conflicts. Managers owning shares in the company bear the consequences of decisions harmful to the company and benefit from those that increase its value (Barnhart & Rosenstein, 1998) .

Also, (Campbell & Minguez-Vera, 2008) in a panel data study of 68 companies listed on the Madrid Stock Exchange between 1995 and 2000, found a positive link between board diversity and company

performance in Spain.

Furthermore, in France, (Ginglinger, Megginson, & Waxin, 2011) studying the link between employee representation and performance on a sample of companies from the French Stock Exchange Society (SBF 120) between 1998 and 2008, showed that employee representation on the board of directors increases the value and profitability of companies when shareholder-employees elect these directors.

Additionally, (Madhar, 2016) aimed to show the relationship between governance and performance by conducting a study on 46 Moroccan issuers between late 2012 and late 2014. She created a grid composed of 31 governance criteria mainly covering board practices and shareholder rights. In order to measure the performance of the companies studied, she favored financial and stock indicators such as revenue, EBITDA, and net margin. The results of this study were able to confirm, once again, the existence of a correlation between governance indicators and the financial and stock indicators of the companies studied.

4.2 Empirical studies questioning the link between corporate governance and performance

Other studies have questioned the link that may exist between corporate governance and performance, demonstrating the vulnerability of this connection.

(Yermack, 1996) tested the effect of governance on performance. The result shows that the effect is negative, insofar as the board loses effectiveness as its size increases.

Also (Dalton, Daily, Ellstrand, & Johnson, 1998), concluded through

their study that there is little relationship between ownership level and performance in the U.S., where the dominant shareholder is generally an individual or institutional investor who does not control or participate directly in the management of the company.

(Hermalin & Weisbach, 1991) and (Bhagat & Black, 2002) failed to highlight a significant link between the independence of boards of directors of large American companies and their long-term performance, despite using data over a long period. They showed, however, that unprofitable companies tend to increase board independence without proving its favorability to their shareholders.

(Poulain-Rehm, 2006) conducted a study on a sample of 131 French publicly traded companies to measure the impact of an employee share ownership policy on value creation. Results contradicted theoretical assumptions by highlighting the absence of a significant impact of employee share ownership on value creation from both shareholder and stakeholder perspectives.

Moreover, studies by (Pham et al, 2007) in Australia and (Firth et al, 2002) in China found no relationship between governance and market performance. Additionally, (Epps et al, 2008) concluded the absence of a link between governance and operational performance indicators.

(Aman & Nguyen, 2007) asserted that in Japan, companies with less rigorous governance are more market-performing than those with stricter governance. This is attributed to the higher risk of the former category compared to the latter, and once this risk is managed, the relationship between governance and returns disappears.

(Suchard et al, 2007)) also observed that good governance is

associated with low stock returns in Australia.

Furthermore, (Adams & Ferreira, 2009) studied a sample of 1939 American companies from 1996 to 2003, considering reverse causality, and showed that board diversity increases managerial control but has a negative impact on performance in American companies. Diversified boards exert stronger control over managers for companies with weak governance but are counterproductive for those with good governance quality. Thus, diversity may have a negative impact on performance on average. Additionally, female directors are found to be more diligent than men in board meetings, although they are not as well-trained for board positions.

5. CONCLUSION

The major scandals of the 1990s and 2000s, such as Enron and Worldcom, significantly impacted corporate governance. These crises prompted a political and shareholder reaction aimed at reforming corporate governance, particularly regarding the composition of boards of directors.

Over time, the concept of governance has broadened, shifting from a purely financial dimension focusing on the relationship between shareholders and executives to a more holistic approach that encompasses all stakeholders, such as suppliers, customers, employees, etc. This partnership approach has challenged agency theory, which advocates for shareholder wealth maximization as the primary objective of the company.

Thus, stakeholder governance, also known as the stakeholder model, has become the most valued form of governance today. The strategy no longer solely focuses on profitability and increasing shareholder

wealth but integrates a broader vision of the value generated by the entity, taking into account environmental considerations.

Through the results of the majority of studies, we can conclude that governance and performance are closely linked. Good governance can significantly contribute to long-term value creation. Companies with such a structure will be better equipped to make strategic decisions, manage risks, foster innovation, and improve financial profitability. Additionally, this will boost investor confidence and enhance the company's credibility in financial markets.

That said, some research has challenged the existence of a positive correlation due to various factors. Indeed, board diversity and size can hinder decision-making, thereby affecting company performance. Moreover, poorly managed conflicts of interest among different stakeholders may favor certain individuals at the expense of the overall company. Also, a lack of transparency in disclosing financial and operational information can lead to a decrease in investor confidence and a negative evaluation of company performance.

The results of these studies underscore the complexity of the subject and the need for further investigation, especially since reality may vary depending on geographical contexts and local specificities.

Thus, the question of the link between governance and performance remains an ever-evolving issue. There is much more to explore, especially in the specific context of Algeria, where the subject is still relatively new. This conclusion paves the way for future contributions and research in the field of governance.

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