Budapest International Research and Critics Institute-Journal (BIRCI-Journal)
Humanities and Social Sciences
ISSN 2615-3076 Online)
ISSN 2615-1715 (Print)
www.bircu-journal.com/index.php/birci
Budapest Institute

Corporate Governance Mechanism and Corporate Performance: A Literature Review

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Abstract

This paper aims to describe the importance of corporate governance and company performance in a company. This research method uses qualitative research methods with a literature review approach. Sources of research data are journal articles from research results between corporate governance and corporate performance. The results of the country study show that each has its own corporate governance model. Corporate governance models such as the one-level system and the two-level system can influence the corporate governance mechanism, as well as being able to control the company's performance.

Keywords
corporate governance; corporate performance

I. Introduction

Improved methods, principles and mechanisms of corporate governance came into effect during the global financial crisis that occurred in the United States in 2008 (Ashwin, 2015). The global financial crisis occurred because of corporate governance failures and weaknesses in the financial industry. It is increasing economic integration around the world, so this problem becomes a global epidemic. The problem of the financial crisis not only has an impact on developed countries but also has an impact on developing countries, especially the Asia-Pacific region including Indonesia (Bapenas, 2009). According to Muller-Kahle & Lewellyn in (Ashwin, 2015) problems are caused by the failure of the board of directors to monitor executives effectively and not being prepared to assess the risks they have taken. Claessens in Ashwin (2015) argues that good corporate governance can be created by adding value through contributing to more efficient management due to increased asset allocation, more effective employment policies, supports higher corporate valuations, higher returns on equity and ensure greater profits and sales growth.

Zheng (2021) states that the corporate governance structure is the main factor from the internal side of the company in influencing the level of operations and development of the company. So that the implementation of corporate governance tends to affect the level of company performance(Al-Shammari, 2021; Munisi & Randøy, 2013; Peng et al., 2021; Yilmaz, 2018). According to Peng (2021) specifically the relationship between corporate governance and corporate performance is the subject of debate in the literature, so that some scientists find it difficult to define good corporate governance and how it affects corporate performance.

Corporate performance is a benchmark seen by a stakeholder in monitoring and controlling management (Sheikh et al., 2018). Therefore, according to Pradiastuti (2020) said that the company's financial performance is one source of company management accounting information to be able to know and assess corporate performance. Corporate performance can be seen through several indicators. According to the conceptualization of corporate performance measurement, it can be assessed through two methods, namely accounting-based and market size (Al-Shammari, 2021).

DOI: https://doi.org/10.33258/birci.v5i2.5028

Budapest International Research and Critics Institute-Journal (BIRCI-Journal)
Volume 5, No 2, May 2022, Page: 11947-11954
e-ISSN: 2615-3076 (Online), p-ISSN: 2615-1715 (Print)
www.bircu-journal.com/index.php/birci
email: birci.journal@gmail.com

Some of the results of previous research on the relationship between corporate governance and company performance have been debated so that the research results are contradictory (Peng et al., 2021). Not all corporate governance mechanisms are equally important in explaining the relationship between corporate governance and company performance, especially since the model used by each country has differences (Munisi & Randøy, 2013). So that in this study the author aims to conduct a literature study on how the mechanism of corporate governance with company performance has a relationship that is seen based on two models, namely one tier system and two tier system. So the researchers conducted a study entitled Corporate Governance Mechanism and Corporate Performance: A Literature Review.

II. Review of Literature

2.1 Agency Theory

According to Lopes (2016) in Jensen and Meckling (1976) agency theory is a social interaction that is seen as a contractual relationship where one person (principal) involves another person (agent) to carry out several activities and gives some authority to the agent. Agency theory appears to minimize problems between company owners and management. Basically, agency theory is to solve two problems that may occur in agency relationships. According to Prondetchi (2020) the problem is a problem that arises when the wishes or goals of the principal and the agent conflict and when it is difficult for the principal to verify what the agent is doing. According to Bosse & Phillips (2016) the problem that arises when one party (principal) employs another party (agent) to create value is that the interests of the principal and agent diverge and the principal has imperfect information, which creates problems with the agent.

2.2 Corporate Governance

The emergence of corporate governance is based on the legal system, such as cases of financial and administrative corruption and demands to pay attention to ethical aspects and codes of ethics in order to protect the interests of individuals and society. The concept of corporate governance according to Munisi & Randøy (2013) is a multidimensional concept, so that it can be defined in various ways such as the mechanism adopted which is categorized into two forms, namely internal and external. Internal mechanisms such as board of directors, debt financing, concentration of ownership, executive compensation and share ownership of executive directors while external mechanisms are product market competition, labor and corporate control.

Companies that adopt good corporate governance tend to perform better than those that do not (Munisi & Randøy, 2013). Defining how good corporate governance works is a concern, because corporate governance is a complex system (Peng et al., 2021). Corporate governance according to Zheng (2021) is a structure that refers to internal organizational mechanisms that can fix principal agent problems and obtain economic benefits by coordinating the relationship between shareholders and the board of directors. In addition , Abutaber et al (2021) define that corporate governance is a set of administrative and accounting rules or systems that are used to regulate and control the work of the company in a transparent, neutral, efficient, and objective manner such as the rights of shareholders and other external parties who are directly related to the company. So corporate governance can be defined as rules within the internal organization that coordinate the relationship between the company and its shareholders and other external parties in an efficient, transparent, and neutral manner.

Increasing the effectiveness of corporate governance requires the separation of ownership and management functions. The ownership function is shareholders or shareholders, while management is the manager of the company, so there is a conflict between the owner and agent, this conflict occurs because of differences in personal interests that can lead to misuse of company assets (Peng et al., 2021). In practice, the corporate governance structure is an internal mechanism that fixes problems between owners and agents in order to generate economic benefits by coordinating the relationship between shareholders, senior management and the board of directors (Zheng, 2021). So basically, the implementation of corporate governance is to reduce agency costs which will improve corporate performance. Companies are required to comply with the corporate governance code of ethics. This is done to result in an increase in share price and shareholder wealth. Companies that implement corporate governance recommendations will improve corporate performance.

2.3 Model Corporate Governance

According to Cernat (2004),states that corporate governance has two different models based on the principles of organizing capital and labor, including the Anglo Saxon corporate governance model and the continental corporate governance model or commonly known as the one tier system and two tier system models.

a. Model Corporate Governance Anglo-Saxon (One Tier System)

The company concept develops a fiduciary relationship between shareholders and managers. The Anglo-Saxon system is a belief that private interests and decentralized markets can function independently and in balance. This model emphasizes institutions based on profit-oriented individual behavior for the success of entrepreneurs and managers. According to Cernat (2004), the one tier system in the capital aspect is characterized by dispersed equity ownership for the management of corporate responsibility, although the separate ownership and control of minority shareholders have protection.

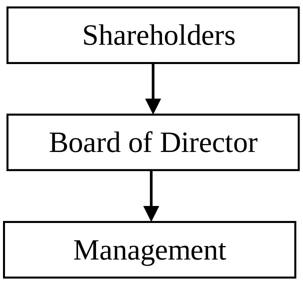

Figure 1. *Model Corporate Governance One-tier system*
Source: (Akal, 2014)

b. Model Corporate Governance Continental (Two Tier System)

The concept of corporate governance in continental Europe differs in principle from the Anglo-Saxons. The principles developed in this model not only consider the interests of shareholders but also take into account the inputs provided by the relevant stakeholders. The two-tier model considers input from the union because the strategic decision making at the company level is the employee. This system allows the employee scheme to appoint or recommend several members to the supervisory board, so this model allows several positions to handle agency problems between shareholders and managers and ensure other oversight.

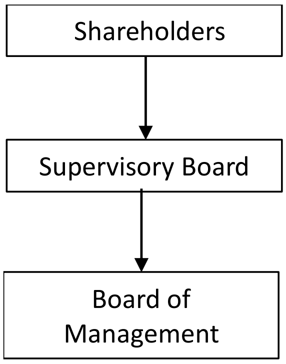

Figure 2. *Two tier system*
Source: (Akal, 2014)

Table 1. The differences between Anglo-Saxon and Continental

	Anglo-Saxon	**Continental**
Human Resources	Poor internal flexibility, weak labor organization, limited employee influence	High internal flexibility, strong union, employee influence through work council
Capital	High internal flexibility, strong union, employee influence through work boards Widespread ownership structure, separation between equity ownership and management, minimal bank role	Shareholders and dividends are less prioritized, family ownership is only important for small businesses, banks have an important role

Source : (Cernat, 2004)

2.4 Corporate Performance

Company management has a responsibility to maximize corporate performance. Maximum corporate performance can show the value of assets owned by the company, for example securities. According to Rahmadani (2017) high corporate performance will reflect that the company has many assets such as securities, equipment, etc., so one of these securities is shares owned by the company. However, poor corporate performance can limit the flexibility of available resources, thereby increasing the rate of dismissing managers whose performance is relatively poor (Hu & Leung, 2012).

Bussin & Ncube (2017) say that the principal has a full understanding of the performance measurement that best reflects the efforts made by the agent. Therefore, corporate performance has important indicators in its measurement, according to Zheng (2021) the company's stock price and book value are important indicators in corporate performance research. The rate of return on assets reflects the efficient use of the capital invested by the company. Zheng (2021) found that equity balance and concentration value had a significant positive impact on corporate performance. So it can be concluded that corporate performance is the achievement of a company in managing its resources as seen from the company's stock price and as an indicator of shareholder confidence in a company.

III. Research Method

The method used is a systematic review of the literature. In this case the purpose of the review is to assess a systematic literature review (which is referred to as a secondary study), so this research is categorized as a tertiary literature review. The various methods for conducting a literature review were identified as “systematic review, meta-analysis, rapid review, literature review (traditional), narrative review, research synthesis, and SLR” (Surana, 2020). Traditional literature review is widely used in accounting research, a more structured approach is being developed. Structured Literature Review (SLR) according to Becheikh et al (2006) is to analyze research published by academics that refers to corporate governance and corporate performance. The mechanism of corporate governance as an independent variable is seen through the size of the board, the proportion of independent directors, the number of board meetings, and management ownership. While the dependent variable of corporate performance is seen through ROA, ROE and Tobins Q. The purpose of this method is to identify the main scientific contributions in a field and the results are often presented descriptively and discussed.

IV. Results and Discussion

In previous studies, there were studies in China which adhered to the two-tier system model. The research was conducted by Zheng (2021) this study uses indicators of board size, the proportion of independent directors, the number of board meetings, the share of senior management ownership to see the corporate governance mechanism in the two-tier model. Meanwhile, research in African countries uses a one-tier system. The research was conducted by (Munisi & Randøy, 2013) by looking at the assessment of corporate governance mechanisms using indicators from the board of directors, audit committee, disclosure and transparency, remuneration committee, and shareholder rights. The assessment of the corporate governance mechanism has a comparison between the indicators used in the two corporate governance models.

Haque & Arun (2016) presented empirical evidence about the effect of corporate governance mechanisms on company performance. In China and Africa, which use different corporate governance models, see the relationship between corporate governance and company performance using indicators ROA, ROE and Tobins Q. According to Munisi & Randøy (2013) These two measures discuss different aspects of performance; the former measures the historical earnings generated by the company, while the latter is a proxy for the future value of the company for a pool of current and potential investors.

The results of Haque & Arun (2016) show that differences in the quality of corporate governance can explain the positive relationship that better corporate governance quality helps companies increase market value. In China Zheng (2021) the results of the study found that the balance of equity and the value of concentration had a significant positive impact on the company's performance because the shareholders paid more attention to the company's development in pursuing profits. (Bussin & Ncube, 2017) say that the principal has a full understanding of the performance measurement that best reflects the efforts made by the agent. Therefore, the ownership concentration value has an important indicator in its measurement,

The second result (Zheng, 2021) states that corporate governance through the size of the board of directors positively encourages company performance to a certain extent. The effectiveness of the board of directors and audit committee can improve accounting performance (ROA) while the results of the audit committee are only significant when associated with market performance (Tobin's Q). This is supported by the research of Gugler et al. (2008) in (Haque & Arun, 2016) mentions that the idea of agency theory has a positive influence on one's ownership in company performance. As in Indonesia, which applies the two-tier model, there are previous studies according to Nugroho (2016) independent commissioners play an important role, especially in terms of financial performance as measured by ROA and ROE.

Munisi & Randøy (2013) in an African country that uses a one-tier system found that the adoption of corporate governance practices with the effectiveness of the board of directors and audit committee can improve accounting performance (ROA) while the results of the audit committee alone are significant when associated with market performance (Tobin's Q). Munisi & Randøy (2013) found that at least 85% of companies have a board of at least 2/3 of the total number of members. Board independence indicators have a significant negative effect on ROA and share ownership concentration has a significant positive relationship with company performance (Peng et al., 2021). Prondetchi (2020) says that board ownership has a significant positive relationship with firm performance, but board size and board independence have no significant relationship with firm performance. According to Nugroho (2016), he found a significant relationship between the number of independent commissioners and audit committees with financial performance as measured by the ROA indicator. Research recently conducted by (Lin et al., 2010) states that one of the indicators of corporate governance has a significant negative effect on company performance as reflected by ROA and EPS.

V. Conclusion

This article describes how corporate governance mechanisms can impact a company's performance. Based on the explanation above, research in several countries that adopt different models of corporate governance mechanisms gives results that the implementation of corporate governance has a significant effect on corporate performance. Although there are indicators that have a significant negative effect, such as the composition of board meeting attendance. In research (Munisi & Randøy, 2013; Zheng, 2021) using the board composition indicator has significant results on company performance both measured by market performance and accounting performance. So that the implementation of the one tier and two tier models found the same results, namely the effect between corporate governance and corporate performance.

Theoretically, implementing corporate governance mechanisms can improve company performance (Haque & Arun, 2016). This supports agency theory's prediction of the quality of corporate governance to be positively related to firm valuation according to the literature review.

This study offers a suggestion that further studies use additional variables such as top level management compensation in influencing corporate performance. This is done in order to see the relationship between the implementation of corporate governance with compensation payments to top level management with corporate performance. There are indications in previous research that a reasonable set of executive compensation can improve company performance (Zheng, 2021).

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