REVIEW OF CORPORATE GOVERNANCE BUNDLE

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Abstract

Due to the importance of corporate governance in our business world today, especially after the frequent non-stop financial crises, and since one corporate governance mechanism may not fulfill the purpose, researchers recently came up with a bundle of corporate governance mechanisms which may complement each other or substitute one another. This paper reviews the literature as regards the evolution, development, current application, and potential future use of this bundle, together with relevant critiques.

Keywords: Bundle, Corporate Governance, Mechanism, Practice

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1. Introduction

Corporate governance is a system used to direct and control an organization. It includes relationships between, and accountability of, the organization's stakeholders, as well as the laws, policies, procedures, practices, standards, and principles which may affect the organization's direction and control (Cadbury, 1992). It also includes reviewing the organization's practices and policies in regard to the ethical standards and principles, as well as the organization's compliance with its own code of conduct.

Corporate governance has become one of the most topical issues in the modern business world today. Spectacular corporate failures, such as those of Enron, WorldCom, the Bank of Credit and Commerce International (BCCI), Polly Peck International, and Baring Bank, have made it a central issue, with various governments and regulatory authorities making efforts to install stringent governance regimes to ensure the smooth running of corporate organizations, and prevent such failures. A corporate governance system is defined as a more-or-less country-specific framework of legal, institutional and cultural factors shaping the patterns of influence that shareholders (or stakeholders) exert on managerial decision-making. Corporate governance mechanisms are the methods employed, at the firm level, to solve corporate governance problems.

Since the corporate governance bundle is viewed as a combination of corporate governance practices or mechanisms (Rediker and Seth, 1995; Ward et al., 2009; Aguilera et al., 2011; Schepker and Oh, 2013; Yoshikawa et al., 2014), firm performance cannot depend on the effectiveness of any one mechanism alone, but on the effectiveness of the whole bundle of mechanisms; and it is very difficult to find a bundle of mechanisms that is effective as a whole. In addition, the governance practices or mechanisms within the same bundle may not relate to each other in a cumulative and monotonic fashion as this requires higher costs and over-governance (Garcia-Castro et al., 2013). Meanwhile, Turnbull (1997) stated that corporate governance scholars should accept the possibility that some people behave as opportunistic self-serving agents while others behave as selfless stewards. Therefore, no one theory or model would be sufficient for understanding, evaluating or designing governance structures.

This paper focuses on reviewing the corporate governance bundle in order to provide an in-depth understanding of the accounting research perspectives and its application to accounting research. The data used are extracted from relevant journal articles that reflect the background of the bundle, its application, and potential future use. In addition to this first section, this paper is organized as follows: the second section provides a background; the application of the bundle is provided in the third section; followed by discussion in the fourth section; and finally conclusion and future research provided in the last section.

2. Background

Corporate governance is traced back to the early 1930s and the publication of Berle and Means "The Modern Corporation and Private Property". It is viewed as an indispensable element of market discipline and this is fuelling demands for strong corporate governance mechanisms by investors and other financial market participants (Blue Ribbon Committee 1999). It deals with the ways in which the corporations' financiers assure themselves of getting a return on their investment, answering the following questions: How do these financiers get managers to return some of the profits to them? How do they make sure that managers do not steal the capital they supply or invest it in bad projects? How do they control managers? (Shleifer and Vishny, 1997).

Although the majority of the respective researchers indicate that Rediker and Seth introduced the concept of the “bundle of governance mechanisms” in 1995 under the section titled “Cost–Benefit Analysis”, some researchers, such as Ward et al. (2009) added that the idea of complementarity and substitutability among control mechanisms can be traced back to the works of Milgrom and Roberts of 1990 and 1995. Millar (2014) defined corporate governance bundles as structures or combinations of rights and responsibilities that operate or interact for the governance of organizations. Aguilera et al. have a history in this regard, as follows: Aguilera et al. (2008) talked about the complementarities of different corporate governance practices; Aguilera et al. (2011) talked about the bundle as a useful tool to examine corporate governance models across and within countries, emphasized that the bundles of corporate governance practices is becoming more important in comparative corporate governance researches, and they categorized the bundle into two governance mechanisms: 1- Complementarity: when the adoption of one increases the marginal returns of the other, and 2- Substitutability:

Replacement of one mechanism by the other, while the overall functionality of the system remains unaffected; Aguilera et al. (2012) indicated that the importance of the bundle of corporate governance practices is becoming more salient in corporate governance researches; and Garcia-Castro et al. (2013) found, among other things, that there are multiple bundles of firm-level governance practices that lead to high firm performance.

Researchers agree on the existence of the complementarity and substitutability relationships and consequent effects within the bundle of corporate governance mechanisms; however, each researcher looked at these relationships and effects from different angle. For example, Rediker and Seth (1995) found that there are substitution effects within various corporate governance mechanisms, and that there is a relationship between monitoring by outside and inside directors (on one side) and monitoring by large outside shareholders and inside directors (on the other); Azim (2012) found that the corporate governance bundle is effective in aligning managers’ and shareholders’ interests, but the effect of any one mechanism may not provide similar results due to the above complementarity and substitutability relationships; Schepker and Oh (2013) found that multiple governance mechanisms are used by boards and owners as complements to limit managers’ opportunism; and that organizations may use other governance mechanisms as trade-offs to limit managers’ powers; Aslan and Kumar (2014) indicated that there are substitutability and complementarity effects among individual firm-level governance; Kim and Ozdemir (2014) reveal that governance mechanisms from both firm’s internal and nation’s external levels could be aligned to form national governance bundles; Yoshikawa et al. (2014) highlighted the role of bundles of governance practices in influencing directors’ engagement in governance behavior.

With all due respects to the above valuable studies and findings, it is still not clear whether one can find an effective whole bundle of mechanisms that can be used to practice the aforementioned complementarity and substitutability. Moreover, the governance practices within the same bundle may not relate to each other in a cumulative and monotonic fashion as this requires higher costs and over-governance (Garcia-Castro et al., 2013). In addition, the range of combinations of corporate governance practices that firms can adopt might be partly limited by the environment, and/or be constrained by the set of governance practices available (Aguilera et al., 2011).

As regards the theories related to the corporate governance bundle, a few previous studies show such relationship. For example, Aguilera et al. (2008) criticized corporate governance research, especially within principal-agent theory and stakeholder theory, and proposed a framework for looking at environmental interdependencies of corporate governance in terms of costs, contingencies, and complementarities related to various well-known practices. In similar context, Young et al. (2008) argued that principal-principal conflicts between controlling shareholders and minority shareholders result from concentrated ownership and other ownership and control issues, and that such conflicts alter the dynamics of the corporate governance process which require remedies different from those that deal with principal–agent conflicts. Consequently, I agree that there is no one size fits all, that the institutional setting in emerging economies calls for a different bundle of governance mechanisms since the corporate governance conflicts in these economies are principal-principal conflicts, rather than principal-agent conflicts.

Moreover, Ward et al. (2009) examined governance bundles under both agency and stewardship theories to tie together previous empirical research and advance theory. They did a good job in reconciling prior disparate findings as to whether or not these governance mechanisms act in a complementary or substitutable fashion. They also showed that, under conditions of poor performance, shareholders can provide effective external monitoring that can improve the firm’s overall governance effectiveness. In addition, Young (2014) contends that scholars, particularly British scholars, should look at four sets of ideas that have each played an important part in shaping the UK governance system: agency theory, resource dependence theory, stewardship theory, and stakeholder theory; especially the agency theory as it is the most influential theory that scholars first turn to, and which has helped to shape recent codes of practice in governance. It is worth-mentioning again that no one theory or model would be sufficient for understanding, evaluating, or designing governance structures since some people behave as opportunistic self-serving agents while others behave as selfless stewards.

In addition to the complementarity and substitutability uses of the corporate governance bundle and the relevant theories employed, a few pervious researches were conducted about national corporate governance bundles. For example, Aslan and Kummar (2014) proposed and implemented a model for forming national governance bundles by combining individual national governance factors that are correlated to agency costs at the firm level, confirming that by providing readily available indicators of different agency costs at this level, these bundles can guide policymakers in setting the legal and regulatory framework for corporate governance at the national level. Moreover, Kim and zdemir (2014) found that governance mechanisms from both firm's internal and nation's external levels could be aligned to form national governance bundles. In the same context, Millar (2014) argued that formal institution and laws develop in alignment with the informal governance mechanisms, and that these formal and informal components of the bundle interact to accomplish the desired corporate governance. With all due respects to the above and other relevant studies, it should be noted that a lot of theoretical and empirical work remains to be done in order to help us understand the varieties of corporate governance practices at both the firm and country levels.

3. Application of the Corporate Governance Bundle

In addition to the aforementioned evolution and development of the corporate governance bundle, the table 1 summarizes the application of the bundle in chronological order.

4. Discussion

Although the literature indicates that the application of the corporate governance bundle has many advantages, it also specifies some relevant limitations. The advantages and limitations are summarized as follows: First, it indicates that the combinations of firm-level corporate governance practices embedded in different national governance systems lead to high firm performance, but firm performance depends on the effectiveness of the bundle, not on any one mechanism alone which makes us wonder how we may reach to such a whole-bundle effectiveness; additionally, the effect of any one mechanism may not provide similar results due to the substitute and complementary relationships. Second, it appears that some costs are justified by the benefits that will be attained by using the corporate governance bundles while other costs might not be justified; that is additional benefits of employing an internal governance mechanism (when combining both internal and external mechanisms) may not always overcome the costs of doing so depending on the existence of governance mechanisms in the external context, and on whether the governance practices in the same bundle relate to each other in a cumulative and monotonic fashion or not; and the question is: how can we know which costs may/may not be justified in order to determine whether to use the relevant bundle or not. Third, the literature also indicates that boards and owners use the bundle to limit the manager's opportunism, and that using the bundle leads to involvement of directors in governance behavior, but this also falls short since some people behave as opportunistic self-serving agents while others behave as selfless stewards, and consequently no one model or theory would be sufficient for understanding, evaluating or designing governance structures.

Fourth, it is argued that there are other advantages of employing the bundle, such as using it in comparative corporate governance researches, forming national governance bundles, and combining internal and external mechanisms into bundles that operate both at the firm and national levels and that guide policymakers in setting the legal and regulatory framework of corporate governance at the national level; but in addition to being costly, the combinations of corporate governance practices that can be adopted could be limited by the environment, culture and ethical demands of the country where a firm operates, as well as by the availability of the set of governance practices.

Table 1. Summary of the application of the bundle in chronological order

Study	Country and/or Field of Study	Findings/Results/Insights
Rediker, K. and Seth, A. (1995)	Board of Directors and Substitution Effects of Corporate Governance Mechanisms	Since a variety of mechanisms are used to achieve alignment of the interests of shareholders and managers, the level of a particular mechanism should be influenced by the levels of other mechanisms which simultaneously operate in the firm. There are substitution effects within the various corporate governance mechanisms. There is a relationship between monitoring by outside directors and the following mechanisms: monitoring by large outside shareholders, mutual monitoring by inside directors, and incentive effects of shareholdings by managers.
Aguilera, R.V., Filatotchev, I., Gospel, H., and Jackson, G. (2008)	Effectiveness of corporate governance in diverse organizational environments in Germany, Japan, Italy, France, Russia, USA, and UK	Developed a critique of corporate governance research, especially within principal-agent theory and stakeholder theory; and proposed a framework for looking at environmental interdependencies of corporate governance in terms of costs, contingencies, and complementarities related to various well- known practices.
Young, M. N., Peng, M. W., Ahlstrom, D., Bruton, G. D., and Jiang, Y. (2008)	Emerging economies. Corporate Governance: Review of the Principal-Principal Perspective	Principal–principal conflicts between controlling shareholders and minority shareholders result from concentrated ownership, extensive family ownership and control, business group structures, and weak legal protection of minority shareholders. Such principal–principal conflicts alter the dynamics of the corporate governance process and, in turn, require remedies different from those that deal with principal–agent conflicts. The institutional setting in emerging economies calls for a different bundle of governance mechanisms since the corporate governance conflicts often occur between two categories of principals – controlling shareholders and minority shareholder.
Ward, A. J., Brown, J. A., andRodriguez, D. (2009)	Anglo-Saxon Countries. Corporate Governance Bundles, Firm Performance, and Substitutability and Complementarity of Corporate Governance Mechanisms	Examined governance bundles under both agency and stewardship theories to tie together previous empirical research and advance theory. In specifying the role of firm performance in determining the mix of mechanisms within the governance bundle, the authors reconciled prior disparate findings as to whether or not these governance mechanisms act in a complementary or substitutable fashion. Also showed that, under conditions of poor performance, shareholders can provide effective external monitoring that can improve the overall governance effectiveness of the firm.
Aguilera, R., Desdender, K., and Castro, L. (2011)	A bundle perspective to comparative corporate governance	There is a wide range of combinations of corporate governance practices that firms can adopt which might be partly limited by the environment but are also constrained or enabled by the set of governance practices available.
Aguilera, R.V. (2012)	France and Germany. Analysis of Michel Goyer's book "Contingent Capital"	The critical insight here is the importance of bundles of corporate governance practices, which is becoming more important in comparative corporate governance researches.
Azim, M. I. (2012)	Australia. Impact of Corporate Governance Mechanisms on Company Performance	Although the corporate governance bundle is effective in aligning managers' and shareholders' interests, the effect of any one mechanism may not provide similar results due to the substitute and complementary relationships. This research provides insights into how the bundle of monitoring mechanisms works to reduce the agency problem.
García- Castro, R., Aguilera, R. V., and Ariño, M. A. (2013)	United Kingdom and others. Analysis of Bundles of Firm Corporate Governance Practices	Using fuzzy set/qualitative comparative analysis, the authors found: 1- that within each of the national corporate governance models, there are multiple bundles of firm-level governance practices leading to high firm performance, 2- evidence of complementarity and functional equivalence between corporate governance practices, and 3- that there can be differences in firm governance practices within each model of corporate governance.
Schepker, D. and Oh, W. (2013)	288 U.S.-based firms. Corporate Governance Mechanisms Effects: Complementary or Substitution	Multiple governance mechanisms are used by boards and owners as complements to limit managers' opportunism; and that organizations may use other governance mechanisms as trade- offs to limit managers' powers.

Table 1. Summary of the application of the bundle in chronological order (Continue)

Study	Country and/or Field of Study	Findings/Results/Insights
Kim, Y. and Ozdemir, S. (2014)	23 countries from all continents	Internal and external governance mechanisms could be combined into Bundles. They indicate: additional benefits of employing an internal governance mechanism may not always overcome the costs of doing so depending on the existence of governance mechanisms in the external context. This finding shows that governance mechanisms from both firm's internal and nation's external levels could be aligned to form national governance bundles. This complementarity supports open systems arguments of corporate governance and rejects the idea of one optimal governance structure. The authors integrated various theories of corporate governance to explain the way a firm structures its board to perform its fiduciary roles effectively.
Millar, C. (2014)	The Existential Issue of National Governance Bundles	Culture and ethical demands of the country where a firm operates affect the development of governance bundles. Formal institutions and laws develop in alignment with the informal governance mechanisms. These formal and informal components of the bundle interact to accomplish the desired corporate governance, and will be subject to change if they fail to satisfy society's wishes. Therefore, there is a continued use of a mixture of governance mechanisms.
Schiehll, E., Ahmadjian, C., and Filatotchev, I. (2014)	Across and within National Systems. Understanding the Diversity of Corporate Governance Practices at the Firm and Country Levels	The articles and commentaries included here reveal the promise of national governance bundles, and hint at how much empirical and theoretical work remains to be done. Taken as a whole, they show how attention to the interplay between firm- and country-level governance mechanisms enriches our understanding of comparative corporate governance and helps to identify how and why governance practices vary both across and within national systems.
Yoshikawa, T., Zhu, H., and Wang, P. (2014)	Industrialized and Emerging Economies. Why and how different combinations of governance practices at national level and at firm level enable or constrain outside directors to engage in their monitoring and resource provision roles	This study enriches the growing body of research on governance complementarity and substitution by highlighting the role of bundles of governance practices in influencing directors' engagement in governance behavior, and consequently advancing our understanding of variation in corporate governance systems across and within countries.
Young, D. (2014)	UK and others. Theories behind Corporate Governance	The argument that there is no alternative to Britain's 19th century governance arrangements is simply based on ignorance, special interest pleading or a blinkered resistance to healthy change. It's about time to revise the legal structures and governance arrangements to be compatible with the modern world. We should look at four sets of ideas that have each played an important part in shaping the UK governance system: agency theory, resource dependence and stewardship theories, and stakeholder theory. Probably the most influential one in this context is agency theory, which is the one that we first turn to, and which has helped to shape recent codes of practice in governance.

5. Conclusion and Future Research

This paper is set out to review the literature as regards the evolution and development of the corporate governance bundle. The paper provides historical and theoretical background of the bundle, its current application and potential future use, together with relevant critiques. In conclusion, there is no doubt that application of the bundle leads to many benefits both at the firm and national levels even though this application has started recently, relatively speaking.

Yet, there is work that remains to be done. Future researches could provide ways to overcome the aforementioned limitations. They may also include: looking towards the contingencies and mediators that may affect the complex relationship between management and shareholders and the bundle of mechanisms that are under the board of directors' control; examining additional types of blockholders such as foreign and strategic investors, and additional firm-level governance mechanisms such as compensation of directors and managers, to develop a more comprehensive understanding of corporate governance bundles; associating between national governance bundles and firm performance to understand whether and how different national governance bundles lead to higher firm performance or whether firm performance acts as a mediator of how monitoring forces of national- and firm-level mechanisms interact; continue examining the concept of national governance bundles by incorporating other combinations of internal governance mechanisms chosen at the firm level (i.e., level of ownership concentration), external mechanisms imposed at the national level (i.e., corporate governance codes), and even mechanisms at the intersection of firm and national levels; and examining the performance and dynamic change aspects of various national governance bundles, answering questions such as: Would firms with the most common governance structure for a nation be better off than those who do not fall into that category? Is there such a thing as a particular combination of governance mechanisms operating at the firm and national levels that is most successful?

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