BOOK REVIEW:
“CORPORATE GOVERNANCE: THEORETICAL ESSENTIALS AND INTERNATIONAL PRACTICES”
by
Aws Alhares and Naser Ibrahim Abumustafa
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José Vaz Ferreira *

* Economics and Management School, University of Coimbra, Coimbra, Portugal

Goverance issues have been an important part of societies since the first years of civilization, especially related to values, ethics, rules of conduct and justice and the way societies should be organized. The term governance must be seen in two different dimensions. In the broadest view, corporate governance is portrayed with respect to the state and society, this is, the way a nation is governed. The second dimension is related to values and culture.

Corporate governance is often studied around theoretical frameworks. The first chapter of this book presents distinctive theoretical frameworks, that are related to different views of corporate governance. Aws Alhares and Naser Ibrahim Abumustafa wrote about the agency theory, the transaction cost theory, and the stakeholder theory. Besides, they compared the stakeholder with agency theory and the transaction cost with the agency theory. They add the stewardship theories, that argue that managers are stewards of the owners and both groups share common goals, and the resource-dependence theories, that defend that a board exists as a provider of resources to executives in order to help them achieve organizational goals (Hillman, Cannella, & Paetzold, 2000). In addition, the link between governance and development is also a big issue to teach, namely, the relationship between the governance theories, policy, and practice and development.

Another interesting topic presented by this book, is the relationship between corporate governance and financial structure, since the quality of financial decisions can have a significant result on the risk of a firm’s operating cashflows. The authors explained how to control corporate financial structures and any risk, that may come from decision-making led by managers that could be influenced by shareholders. However, it should be interesting to examine whether and how a country’s financial structure and its legal system, impact a firm’s corporate government structure and its market performance. It is pertinent to know how firm corporate governance varies across different combinations of financial structure and legal system. Also, it should be interesting to know if distinctive corporate governance mechanisms impact firm performance differently, in different combinations of financial structures and legal systems. In addition, it should be...
pertinent to know if a host country’s financial structure and legal systems, impact firm-level corporate governance and, as a consequence, its performance.

The role of institutional investors in corporate governance is also presented in Chapter 4 of this book. The responsibility of institutional investors is to ensure effective corporate governance and they have a high influence on company management, making sure that management interest matches the shareholders’ interest. The authors should develop the role of institutional investor shareholder activism since the early 1990s, which arises due to the conflict of interest between managers and shareholders, as it was praised as a promising means of reducing agency costs. If shareholder monitoring could limit managers’ divergence from the goal of shareholder wealth maximization, then institutional shareholders were well-positioned to act as effective monitors. According to Randall (2008), the institutional investors would have the power and the incentives to push for good corporate governance and to nudge managers to pursue wealth-maximizing strategies. That is, large shareholders, that, simultaneously hold large debt and/or equity positions in a corporation, have been motivated to actively participate in a company’s strategic direction.

In Chapter 5, it is analyzed the board of directors’ impact on performance and the role of non-executive directors (NEDs) in the governance of corporations. Firstly, the authors examined how a well-structured board of directors can influence and mitigate company governance. On the other hand, they analyzed recent changes in the structure and functioning of UK boards and the role of NEDs in company governance. In order to enrich this chapter, some additional contributions could be added. In the first place, as predicted by some theories, such as the agency theory, the steward theory, and resource dependence theory, the link between the board of directors and firm performance should be examined. On the other hand, the NEDs key accountabilities should be revised, such as, the following: providing an independent view on the running of the business and governance; providing independent counsel to the Chairman and Group CEO; providing scrutiny of executive and business performance in meeting the agreed strategy, plan, goals and objectives, as well as reporting of performance; providing independent oversight and challenge and ensuring, with the board as a whole, the effective implementation of board committee decisions by the CEO and the executive.

The compensation committee and its underlying function to executive compensation is another topic presented in this book. The authors concluded that many companies have a remuneration committee, which sizes were positively related to market capitalization. In addition, they found that econometric evidence exists in terms of the relationship between compensation committee structures and executive compensation. This chapter could be enriched with the understanding of the relationship between compensation committees, CEO compensation, and CEO incentives in entrepreneurial firms. Thus is, it should be interesting to know if CEO compensation and incentives are determined by companies, considering the potential self-interest of compensation committee members. Also, it would be important to find out if insiders or CEOs from other firms, who are members of the compensation committee, have, or not, an impact on the level of CEO compensation or structure of equity incentives.

In Chapter 7, the authors developed a theoretical model to examine the interaction between information quality and the takeover market as one of the corporate governance mechanisms to discipline managers. Thus, the chapter analyses
the relation between takeovers and company performance, the likelihood of takeovers success, the post-acquisition performance, the management turnovers subsequent to takeover, and the consequences of taking over failure. The chapter should be enriched by the study of the relation between corporate governance and hostile takeovers, and to try to understand the reasons why hostile takeovers occur, namely, if it is to replace managers who are not maximizing shareholder wealth. Also, it is important to know, if the potential replacement of these managers through a hostile takeover, provides incentives for them to take actions that keep the stock price as high as possible.

The role of venture capitalists and buy-outs is also explained by the authors in this book. They made a summary of the main venture capitalists and buy-out issues with respect to corporate governance. In fact, they present empirical evidence of the effects of buy-outs on corporate governance with respect to the stock market responses, operating performance and strategy, productivity, capital expenditure and research, transfers from other stakeholders, previous owners, and taxation and longevity. Venture capital is an important funding source linked to the development of the largest companies. This chapter could be enriched with the examination of ventures capital activities around the world, and link such activities with corporate governance across countries.

The prosperity of the venture capital industry in the 1990s raises an interesting question that should be investigated, that is, to know if the level and growth of venture capital investments depend on corporate governance.

The audit function and the role of regulation is another topic that was analyzed by the authors. In fact, the evaluation of the financial records by the auditors is crucial to the future of any company. It was referred to the importance of the audit committee role, with respect to improve the organization’s operation, to implement the best strategy to help achieve its goals. Also, the authors developed the agency theory and asymmetric power, rating agencies, regulation, and regulating agencies. Regulatory responses to the global financial crisis have focused on more disclosure requirements relating to corporate governance and this has been conducted to increased awareness and demand for internal assurance on corporate governance processes, including internal control and risk management. Given its unique position within the company, the internal audit function should be presented by the authors, since it has a crucial position to provide this assurance, being a crucial component of corporate governance.

International corporate governance is another topic presented by the authors. They analyzed the available external governance mechanisms, the takeover market, and the legal system. Also, the second-generation corporate governance research was referred to, namely, the legal protection and economic growth and the relation between and ownership. The first generation of international corporate governance research examines individual governance mechanisms, as board composition and equity ownership, in individual countries. The second generation of international corporate governance research considers the eventual impact of various legal systems on the structure and effectiveness of corporate governance and compares systems across countries. For many countries in the world, there is little empirical evidence on governance mechanisms, other than legal protection and ownership structure. Such topics as compensation, board structure, and changes in control, have not been studied in less developing countries. This may suggest the dominant role of ownership structure in these economies and weaknesses in their legal
systems. It should be interesting to analyze for those countries, the evolutions in the legal structure and what aspects of legal systems evolve, the effects of those changes on the role of other company-specific government mechanisms, and the effects of such changes on the strength of economies and the actions and value of companies. Answers to these doubts will increase the knowledge of the role of corporate governance throughout the world.

Discharging broader corporate accountability is another issue presented in this book. There is a growth in the importance of corporate social responsibility. The authors started on the early roots of corporate social responsibility in the UK and presented the relation between corporate social responsibility and financial performance. They outlined the corporate environmental reporting and its key characteristics. Attempts to broaden corporate accountability, mainly involve theories of different forms of accountability. This strand of accountability literature does not specify the direction, content, means, and practices that could be associated with these accountability theories, and how the corporate sector could or should address these forms of accountability. Through appropriate accountability processes, practices and mechanisms, corporate accountability could be broadened downwardly.

Socially responsible investment (SRI) is the final topic of this book. The authors developed the socially responsible investment strategies, the growing demand for social, ethical, and environmental disclosure, the socially responsible investment in an international context, the drivers of socially responsible investment, and the pension fund trustees and the socially responsible investment. In fact, the development of SRI not only has grown significantly, but also it has also matured since it has become more complex and begun to enter the mainstream of investment practice. This maturation of SRI has good implications for its relationship with corporate social responsibility (CSR). Thus, research will be important to track and understand what is happening, as we enter this mature phase of SRI, maybe building on earlier research into dedicated SRI retail funds.

REFERENCES


