SOME ISSUES IN OWNERSHIP STRUCTURE AND CORPORATE GOVERNANCE

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Abstract

Corporate governance is a process that aims to allocate corporate resources in a manner that maximizes value for all stakeholders — shareholders, investors, employees, customers, suppliers, environment and the community at large and holds those at the helms to account by evaluating their decisions on transparency, inclusivity, equity and responsibility. Corporate governance has been commonly defined as the rules and procedures in place for governing an organization. It is the set of processes, customs, policies, laws, and institutions affecting the way a corporation (or company) is directed, administered or controlled. Corporate governance also includes the relationships among the many stakeholders involved and the goals for which the corporation is governed. Corporate governance principles and codes have been developed in different countries and issued from stock exchanges, corporations, institutional investors, or associations (institutes) of directors and managers with the support of governments and international organizations. As a rule, compliance with these governance recommendations is not mandated by law, although the codes linked to stock exchange listing requirements may have a coercive effect. However, given the rapid developments within the field and the increasing prominence of corporate governance in the modern world, this definition may be considered too narrow. Corporate governance, while a topic that has been examined in considerable depth in many areas, is widely applicable to a vast array of topics and issues. This study contributes to the literature by extending the mainly based on board literature to where there are important institutional differences and issues in ownership structure and corporate governance system and seeks to address new and emerging issues which have yet to be closely examined and have, to a degree, been overlooked.

Keywords: Corporate Governance, Ownership Structure, Emerging Market Introduction

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Introduction

Corporate governance is the process by which companies are directed, managed and controlled. Shareholders as owners, individually and collectively rely on the directors appointed by them to oversee the management of the business on their behalf. Directors are accountable to their shareholders and shareholders participation is necessary to make that accountability effective. This should be done in a structured way so as to be progressive, effective and fair and not to in any way hamper the overall business objectives of the company. While company law and regulations provide a legal framework this code is meant to provide a wider operational, structural/ process for discharging the corporate governance activity. The financial benefit of implementing appropriate corporate governance structures and processes, which results in increased investments and share valuation is of great significance in considering stakeholders. Corporate Governance describes the relationship and the rules that govern the relationship between the companies' management, its shareholders, regulators and other stakeholders. It characterizes the structures, the framework and the processes of all economic measures. Policy makers are now more aware to the contribution good corporate governance can have to the financial markets stability, to the economic growth and to a sustainable development. Corporate Governance lies at the heart of the global corporate social responsibility discussion. Businesses all over the world have begun to engage in activities to enhance their positive impact on societies and good corporate governance is the foundation for everything that comes after. Corporate governance and Corporate Social Responsibility are both value-driven. They foster the democratic values of fairness, accountability, responsibility and transparency in corporations and companies. While good corporate governance serves as the basis, CSR builds upon this basis to foster sustainable development. Corporate governance rules need to encourage and not burden

businesses. Corporate governance is of crucial importance for economic development in partner countries. Not only companies but regulators as well, need to drive forward improvements in corporate governance and collaborate with others in order to provide the right incentives. Sustainable development policy and CSR are natural allies. All support companies that take their responsibilities seriously; companies that are interested in more than just making a fast buck at all cost; companies for whom CSR is not a cryptic abbreviation but part of their corporate philosophy. The private sector can greatly contribute to sustainable development worldwide. The modern business cooperation is a powerful motor and not a brake for creating wealth and prosperity and is convinced that without sustainable economic development, sustainable development will remain an illusion. The ongoing expansion in the size and activities of corporate organizations can cause the corporate managers to further their own interests or accrue benefits to themselves at the expense of their shareholders. If the board of directors in a company does not ensure adequate monitoring of management's activities, the interests of investors and creditors could be jeopardized. This could also result in agency problems for the company, which, in turn, could lead to financial crises. Therefore, it is imperative that the mechanism for monitoring corporate organizational activities should function effectively. The importance of stakeholder vigilance and commitment to ensuring compliance with regulation cannot be over-emphasized but in like vein, the regulators are also tasked with the challenge of implementing sustainable and effective enforcement mechanisms that ensure operators adhere to and comply with over time.

This paper is a review of some issues of ownership structure and corporate governance to seek out the major problems with an alternative perspective on how they should be addressed in order to improve corporate performance, ultimately for the benefit of economy development. Fundamentally, normative research approach used to review issues in ownership structure and corporate governance. The remainder of the paper is organized as follows. Section I analyses issues of ownership structure. Section 2 contains a brief review of the literature, whereas section 3 presents conclusion.

Overview issues in ownership structure and corporate governance

The conventional view that the distribution of a firm's share ownership has no influence on the value of the firm has been challenged by a view that can be traced back to Berle and Means (1932) and Jensen and Meckling (1976). These studies predict that corporate value is a function of how shares are allocated to insiders and outsiders. As suggested by Navissi and Naiker (2006), evidence on the relation between the distribution of share ownership and corporate value. The evidence suggests that the make-up of the ownership structure of a firm is an important factor in the corporate governance process. Also the findings show that institutions with board representation have greater incentives to monitor management, and therefore their presence should have a positive influence on firm value. However, at high levels of ownership, institutional investors with board representation may induce boards of directors to make sub-optimal decisions. The principal-agent liaison that survives between owners and managers of a firm gives rise to agency conflicts as the interests and incentives of the two parties become misaligned. This misalignment is likely to be reduced when managers hold a greater fraction of the shares outstanding. Weston et al. (1998) state that when managers' share ownership initially increases, their interests are better aligned with shareholder interests and opportunistic behavior will decline. Institutional investors tend to have a fiduciary responsibility, the responsibility to act in the best interests of a third party (generally the beneficial or ultimate owners of the shares). Until recently, this responsibility tended to concentrate on ensuring that the investors invest in companies that not only were profitable but would continue to be so. While this remains the case, Governments and interest groups have raised the question of how these profits are achieved. Institutional investors today are much more concerned about the internal governance of the company and also the company's relationship with other stakeholder groups. While institutional investors are prevalent in the shareholder base of many countries, many companies across the world do not have a predominance of institutional shareholders in their structures. Some are family-owned, while others are owned by the State. Yet corporate governance is still very important for these companies. Because corporate governance is fundamental to well-run companies that have controls in place to ensure that individuals or groups connected with the company do not adversely influence the company and its activities and that assets or profits are not used for the benefit of a select group to the disadvantage of the majority. This shareholder involvement is only logical: our clients, as shareholders, are part owners of the companies. They, as owners, employ the management to run the business as their agents (economic theory calls this area the "agency problem"). Inevitably, conflicts of interest will arise for the management in this situation. For example, it may be tempted to enter into a major acquisition that may add little value for shareholders but might be in management's interests by raising its prestige or protecting it from the threat

of a hostile takeover. The clearest area where the conflict of interest arises is in executive remuneration, where shareholders' money is passed directly to the management. To regulate these conflicts of interest, there need to be checks and balances to ensure that shareholders' interests are protected. These checks and balances are the foundations of corporate governance. A key feature of disclosure is a genuinely independent audit of a company's accounts. Repeated experience in developed economies shows loss of investor confidence in the company when the accounts are unexpectedly restated. Usually the results are not so dramatic, but even so, doubt regarding transactions or the independence of the audit can have a corrosive effect on shareowner confidence and so share valuations. Being able to rely on the accounts produced by a company is a fundamental requirement of minority shareholders. The published accounts are their main insight into a company's financial position and provide basic data on the health of existing investments. They also provide a valuable guide to management's ability to generate an adequate return on the funds available to them, and therefore to the decision whether to make and maintain an investment. Minority shareholders need to be able to rely on the accuracy and independence of published accounts and that is why public companies are required to have their accounts audited by an independent professional firm. One key way to minimize the agency problem is to have managers themselves acting as owners. The easiest way to achieve this is for them actually to be owners. Investors therefore favor equity-linked remuneration which ensures that executives build up substantial stakes in the business. This should ensure that they act in the interests of all shareholders. Many investors are, however, concerned about the use of share options as an incentive. The danger with options is that the managers do not in fact feel like long-term owners, but rather are inspired to exaggerate the success of the company to the point when the options vest, exercise them and at once sell the resulting shares, without ever becoming true shareholders.

The corporate governance debate also addresses the distribution of power, a central issue for any government or economy, as well as for any company. The inclusion of other stakeholders presupposes a balance between economic and social objectives and the reconciliation of the interests of individuals, the company and society. Various examples from many countries show that failure at the management level can have an enormous impact on the economy as a whole, causing significant damage not only to shareholders and bondholders, but also to employees, suppliers, customers and society in general. The lacks of consideration for stakeholders' common today and the small group of people seriously involved in are expressions of a deficit. Whether this situation can be remedied depends on the one hand on a realization of the "powers that be" that this circle must be expanded. On the other hand, it depends greatly on the ability of stakeholders, poorly represented so far, to make use of an existing channel. For many investors, corporate governance is an additional risk that requires assessment when they are evaluating potential investment opportunities. If investors are unable to evaluate this risk, they are likely to be reluctant to invest or will require a significant premium to mitigate the unknown. In many cases where investors are unable to evaluate the risks associated with governance practices, equities may be incorrectly priced. This works to companies' disadvantage and raises the cost of capital. For all boards, effective board governance depends on both the competencies that individual governors bring with them and the training that the board provides to help governors master board issues and develop the skills needed to participate effectively.

Literature Review

According to Shleifer and Vishny (1997), ownership concentration itself is an important determinant of effective corporate governance. It is accepted that systems of corporate governance are a result of different historical developments, different cultures and different economies (Clarke, 2001). It is claimed that the higher the ownership of the firm by the management, the less the conflicts among the stakeholders, the less the agency problem and cost associated with it (Friend and Lang, 1986; Jensen and Meckling, 1976). This is because the insiders have incentives to protect shareholders interests and need less supervision by the board, since board activity is a costly monitoring alternative (Vafeas, 1999). It is also said that increased agent ownership reduces the need for monitoring as the incentive alignment is enhanced. There are a number of literatures devoted to whether the mechanisms used to reduce agency problems and its costs affect the firm value. It is assumed that if the agency costs are reduced it will increase the firm value. Morck et al. (1988), Bhabra (2007), Benson and Davidson (2009) and Jelinek and Stuerke (2009) find that managerial ownership is nonlinearly related to agency costs and firm value. Regarding ownership structure and corporate governance, Abraham and Cox (2007) find positive associations between number of executive/independent directors and risk reporting. The appropriate ownership structure when a multinational enterprise decides to invest in a foreign market and then to establish an affiliate, has been a central issue in economic theory. Although the globalization process has suggested that international alliances are essential to the success and survival of

multinational enterprise in a foreign market. Encouraging stock ownership among directors is often used to align the interest of directors with those of the shareholders. There are two competing theories about how board of director members, acting as agents for the stockholders, react to owning stock in the firms they serve. The first theory, called ‘‘convergence-of-interests’’, posits that when managers on the board have no stock ownership, they are self-oriented but they have little power to overcome corporate controls designed to align their actions for the benefit of the stockholders. One such corporate governance mechanism is the existence of independent board members who could influence the managers on the board, which has been shown to result in less fraud and earnings manipulation (Beasley et al., 2000; Klein, 2002a). The second theory, called ‘‘entrenchment’’, has similar expectations about managers and directors at extremely low and extremely high levels of stock ownership. At low ownership levels their interests are not aligned with the stockholders, but they possess so little stock that they have no power to subvert governance mechanisms. Elzahar and Hussainey (2012) find no impact for board size, role duality, board composition and size of audit committee on risk reporting in interim reports of UK companies. The financial literature has related dividends to the firm’s future profitability. Miller and Rock (1985) explain optimal dividend payments as signals of future profitability. Rozeff (1982) argued that higher dividend payments reduce agency conflicts between managers and shareholders and found evidence of relationships among growth, profitability and dividends.

Conclusion

Corporate governance involves ‘‘a set of relationships between a company’s management, its board, its shareholders, and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined”. The need of corporate governance appears from the conflicts of interest between corporate insiders and outsiders. These, in the presence of distorted information permit managers (the agents) to hunt their own objectives that may not be aligned with these of the owners (the principals). Hence, managers may conduct actions according to their own self-interest that may not always be beneficial for shareholders. So that, good corporate governance must provide suitable incentives and rewards for the board and the management to pursue in the interests of the company and the shareholders, to facilitate effective monitoring, and to encourage firms to use resources more efficiently. Another main problem with corporate governance and this is a challenge to academics and code makers who want to understand causal relationships and develop structural prescriptions, is that it ultimately it is an issue which is to be dealt with company by company, board by board, as each individual board member steps up to the plate or doesn’t. Due to fact that growing desire among many companies to be more professional, especially in response to ever more demanding shareholder and stakeholder expectations, There is probably increased recognition that training at the board level is desirable. At the company level, adopting governance practices consistent with increasingly accepted principles of corporate governance in global markets. However, there is no one model of corporate governance that works in all countries and in all companies. Indeed, there exist many different codes of “best practices” that take into account differing legislation, board structures and business practices in individual countries. However, there are standards that can apply across a broad range of legal, political and economic environments.

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