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CORPORATE GOVERNANCE: A LITERATURE REVIEW

Brikend AZIRI
Faculty of Business and Economics, South East European University
b.aziri@seeu.edu.mk

Abstract
One of the most often used words not only in management and organizational science, but in economy in general is the word "corporation". Corporations are of the most often forms of organizing a business activity. They are present in all parts of the world, although not to the same extent. Even besides the many joint characteristics of corporations, still they differ from each other in a great amount of aspects. The differences have to do with their size, type of industry in which they are active, way how they are internally organized. The aim of this paper is the analysis of corporations and corporate governance.
Keywords: Corporation, corporate governance, corporate performance

1. INTRODUCTION

1.1. The nature of corporations

The way how modern society functions is closely connected to the production of goods and services that fulfill human needs. Business companies as the main element in the productions process from this point of view enable the normal functioning of human society. Without them contemporary societies cannot be imagined.

One of the most often used words not only in management and organizational science, but in economy in general is the word "corporation". Corporations are of the most often forms of organizing a business activity. They are present in all parts of the world, although not to the same extent. Even besides the many joint characteristics of corporations, still they differ from each other in a great amount of aspects. The differences have to do with their size, type of industry in which they are active, way how they are internally organized. The characteristics of corporations are connected to the characteristics of countries in which they function. Most big and powerful corporations have originated in developed countries.

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Even beside the great importance of corporations, still it's very difficult to give one definition that would incorporate all features and indicate the entire importance of corporation in nowadays national economies.

Even though a great variety of definitions on corporations can be found throughout the world literature a perception can there is some sort of agreement regarding the characteristics, rights, responsibilities and obligations of corporations exists.

A corporation is a profit-seeking enterprise of persons and assets organized by rules. Most of these rules are determined by the unilateral action of corporate organs or officials. Some of these rules are determined by market forces. Some are determined by contract or law. (Eisenberg, 1989).

Although corporations as we know them today came into existence one and a half century ago, their forefathers can be found in the times of Hammurabi, Ancient Greece and the old Rome. Since 1248 in France the privilege of incorporation was granted to trading entities in order to encourage investments for the general wellbeing of the society. In England corporations date as far as from the XVI century. The fore comers of modern companies can be found in the form of the many guilds that operated in XII-the century London. Their importance surfaced specially during the XIII century when individual guilds became so big and powerful that they were even engaged in "wars" among themselves.

The creation and development of the oldest British corporations, which are also regarded as some of the oldest corporations in the world is presented in table 1.

TABLE 1 - THE OLDEST CORPORATIONS IN UK (NACE, 2003)

Name	Year of creation
Russia Company	1553
Spanish Company	1557
Eastland Company	1559
Turkey Company	1581
Morocco Company	1588
East India Company	1600
Virginia Company	1606
French Company	1609
Hudson's Bay Company	1670
Royal African Company	1672
Greenland Company	1693
South Sea Company	1711

In 1776 Adam Smith published his Wealth of Nations in which among others he expressed his negative attitude towards corporation's which he considered to be entities that bring harm to citizens. His negative opinion for corporations that were granted the right to be natural monopolies can be easily notices from his following words:

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Since the establishment of the English East India Company, for example, the other inhabitants of England, over and above being excluded from the trade, must have paid in the price of the East India goods which they have consumed, not only for all the extraordinary profits which the company may have made upon those goods in consequence of their monopoly, but for all the extraordinary waste which the fraud and abuse, inseparable from the management of the affairs of so great a company, must necessarily have occasioned. The absurdity of this second kind of monopoly, therefore, is much more manifest than that of the first.

The development of corporations in Great Britain intensified in the XIX century parallel with the industrial revolution in order to secure the needed finance for the ongoing industrialization. In fact many authors argue that the industrial revolution in the UK and USA would not have occurred if there were no corporations.

After the American Revolution corporations began to develop slowly but with sure steps in the territory of the USA were according to the constitution the regulation of corporations and corporate governance was and is placed in the hands of the separate states. In fact in that time around 300 corporations existed in the territory of USA. In the period 1790-1860 around 2.000 corporations were active throughout the USA, most of them in the transporting industry.

Two periods can be distinguished in the history of the development of corporations in the USA: the period before the civil war and the period after the civil war. The period before the civil war was characterized with the existence of many limitations for the corporations (Nace 2003):

- Activities Each corporation was limited to performing a specific function, such as operating a school or a bridge.
- Lifespan Typically, charters of incorporation were issued for terms ranging from 20 to 50 years, after which they would have to be renewed. Banks were subject to especially tight restriction, with
- Some states limiting terms to 3 to 10 years.
- Property ownership. Most states limited corporations to owning only property that was directly needed for the authorized activity.
- Size Charters directly limited on the amount of capital that an individual corporation could control. Some charter provisions also had an indirect effect on size, including restrictions on

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property ownership, the requirement for unanimous shareholder consent in major decisions, geographic restrictions, and limits on permitted activities.

- Geographic Most corporations were not allowed to operate beyond the borders of the state in which they were incorporated. Sometimes a corporation was even restricted to a single county.
- Inter-company ownership As a rule, corporations were not allowed to own stock in other corporations.
- Performance criteria In addition to stating what sort of activities were allowed, charters also frequently specified project completion dates and output requirements. Sometimes the two were combined; e.g. an iron company being required to reach a certain tonnage of production within three years.
- Profits Charters sometimes limited the profit a corporation could earn. In addition, many charters required that profits from a company be used to buy back stock, so that eventually all stockholders would be eliminated and the company would in effect become a public entity under the supervision of the state legislature. Under the Turnpike Corporation Act of 1805, Massachusetts authorized the legislature to dissolve turnpike corporations once their receipts equaled the cost of construction plus 12 percent.
- Public privilege Charters for turnpikes typically exempted farmers, worshippers, and poor people from paying tolls.
- Shareholder restrictions and protections for minority owners In some cases incorporators had to be citizens of the state. Some charters prevented a single powerful individual from controlling the corporation; some required a minimum number of shareholders. Some charters required that the corporation use a voting formula that increased the leverage of small investors. Most required unanimous consent for key decisions, such as issuing new stock or selling the company.
- Special restrictions on banking Bank charters were limited to three to ten years. Banks had to get special approval to merge. In some states banks were required to direct their loans to local industries. Banks were also required to lend money to the state government if requested. Maximum interest rates were designated. Both Illinois and Indiana actually banned private banking corporations in their state constitutions. Wisconsin and four other states amended their constitutions to require that all bank charters be approved by popular vote.

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- Shareholder liability Limited liability the principle that shareholders can't be held responsible for judgments against a corporation or for unpaid corporate debts wasn't a widespread feature of the corporation until after the Civil War. Some charters required full shareholder liability. Others capped liability at twice the value of a person's stockholdings.
- Ultra vires. In addition to other restrictions, corporations were subject to the general ban on activities not expressly permitted in their charter. This doctrine of limited authorization, known as ultra vires, translates as "beyond the powers." Courts would not enforce any contract outside the scope of a corporation's charter.

From the above presented text it's clear that during this period a negative attitude towards corporations existed. This can be understood even from the thoughts of Thomas Jefferson in 1816:

I hope we shall... crush in its birth the aristocracy of our moneyed corporations, which dare already to challenge our government to a trial of strength and bid defiance to the laws of our country.

In the period following the civil war a sort of "liberalization" in the functioning of corporations in USA occurred. In 1846 the states of New York and Iowa were the first to simplify the procedures for creating a corporation and practically by the beginning of last century the procedures for the foundation of a corporation were reduced to filling forms. Besides this the corporations were allowed to perform activities beyond the boundaries of their domestic states, own shares in other corporations and even perform all legally allowed activities.

Although the creation of corporations is usually considered to have ocured in the UK and USA, the oldest corporation ever is considered to be Stora Enso fonded in 1288 in Sweden. In the begining this company worked in the mining industry, but nowdays it is conducting a sucesful business in the wood industry that is the production of copy paper. This company has over 27.000 employees in 35 countryes around the world and revenue of around nine bilion dolars.

2. CHARACTERISTICS OF CORPORATIONS

Corporations have the following characteristics:

- Corporations must fulfill some formal requirements before being allowed to function and exist,
- Unlimited lifespan,
- Separation of management and ownership,

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- Limited possibilities for landing capital under certain circumstances.

Besides the above mentioned, corporations have a whole range of other characteristics, table 2.

TABLE 2 - BASIC CHARACTERISTICS OF CORPORATIONS (KOSTYUK ET AL., 2007)

Characteristic	Description
Separate legal personality	A company has its own legal personality. Consequently it can be a party to contracts and the subject of rights and liabilities. Furthermore, the existence of a corporation may continue indefinitely unless and until it is liquidated.
Separation of management from ownership	There is a formal separation of the company's management (under the board of directors) from the shareholders. The latter are sometimes termed "the owners" of the company. They share the company's Profits. As they are collectively entitled to appoint and remove directors from the board, they exercise ultimate control over management.
Limited liability	Starting point for this feature is the company's responsibility for its own debts and liabilities. In other words, the shareholders share the company's profits, but they are not responsible for its losses. They are only liable to the company to pay up their share capital and have no further liability. So limited liability actually shifts the risk of business failure from the company's shareholders to its creditors. This appears to give the company's owners and managers too much of an incentive to take risks and can lead to an inefficient use of resources.
Transferability	A share in a company carries rights against the company to receive dividends and (usually) to vote at shareholders meetings. Furthermore it carries any remaining liability to pay up capital. A share can be transferred to a new holder and this transfers the associated rights and liabilities. Shares in a public company are usually traded on a stock exchange, facilitating transfer and making shareholding a more flexible kind of investment.

Corporations have a variety of advantages (Kaliski, 2007):

- Stocks. A corporation can issue and attempt to sell stock. Every share of stock owned represents a share of the corporation's ownership. A corporation may even give its stock away for any reason; for example, as a donation to a charity, or as a reward to employees for industrious service.

- Dividends. A corporate board of directors has the authority to declare and pay dividends in the form of cash or stock. Cash dividends are ordinarily payable from current net income, although net income "kept" from previous years may also be used. A common name for net income kept is "retained earnings." Recipients of stock dividends receive shares of stock in the corporation, thereby increasing the total number of shares they own. Stock dividends are declared from capital stock that has been authorized but not issued.

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- Limited Liability. If a corporation suffers large financial losses or even terminates its existence, the shareholders might lose part or all of their total investment. However, that is ordinarily the extent of their loss. Creditors cannot satisfy their claims by looking to the personal assets of corporate shareholders as they can with a sole proprietorship or an ordinary partnership.
- Corporations have the basic right to conduct a business in which they sell products or services and to engage in either a profit seeking or a non-profit-seeking enterprise.
- Corporations have the right to own, sell, rent, or lease real or personal property.
- Corporations may sue other business entities, such as another corporation, a partnership, or a sole proprietorship.
- Corporations may merge with other corporations.
- Corporations may make contracts with either another business or a person.
- Corporations may hire or discharge employees of any rank, from entry-level employees to the chief executive officer (CEO).
- Corporations may borrow money.
- Corporations may make any lawful investment.

Besides the many advantages, corporations face a series of disadvantages such as (Kaliski,2007):

- Risk. By engaging in business activities, corporations are at risk, great or small. Profit-seeking corporations may very well find the large profits they seek. But they risk huge economic losses and even bankruptcy.
- Suits. Corporations may be sued by any business, including other corporations. They may also be sued by individuals or groups of persons.
- Income Tax. Corporations must pay federal and state income taxes on the net profit they make during a calendar or fiscal year. People who receive cash dividends must also pay income tax for the year they are received. Thus it is often said that corporation profits are subject to double taxation. Corporations receive no deduction for any cash dividends that they pay. Recipients of stock dividends, however, postpone payment of income tax on stock dividends until they sell the stock.

Monks and Minow (Monks., et al,) go a step further and talk about the purposes of a corporation:

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- Human satisfaction. The corporate structure allows value to be placed on differing contributions that combine together so that the whole is greater than the sum of its parts. Through corporations, skills and experience can be competitively marketed and rewarded according to their contribution to value. Corporations have provided a means for the ambitious to achieve, the enterprising to prosper, and the ingenious to be enriched beyond their fondest expectations – the role played by the church or the military or the crown at other times and in other cultures.
- Social structure. Human beings have created social structures since their cave days, in order to foster cooperation and specialization. Corporations offer lasting and resilient social structures.
- Efficiency and efficacy. Corporations enable people to get things done. The words "businesslike," "professional," and "enterprise" are synonymous with beneficial efficiency and efficacy. The translation of an idea into a product; human ingenuity into bricks, mortar, and equipment; and savings into "growth stocks," has materially enhanced the lives of many people in democratic capitalist societies.
- Ubiquity and flexibility. Corporations give individuals a greater and more lasting sphere of action. Corporations have no boundaries in time or space. A corporation continues despite the death or retirement of its highest officers. A corporation that is chartered in Delaware can do business anywhere in the world. Corporations can be moved. They can be transformed by a revision to their legal or financial structure. A corporation's officers and directors can change its place of incorporation, close existing places of business and open new ones virtually without restraint, and reallocate investment capital.
- Identity. Corporations are "persons" within the meaning of the United States Federal Constitution and Bill of Rights. They are entitled to protection against the taking of their property without due process of law. They are entitled (at least to some extent) to freedom of speech. They can contribute money to political causes and campaigns, though some restrictions apply, due to post-Watergate reforms.

3. TYPES OF CORPORATIONS

According to the reasons for their creation, number of shareholders, the opportunity to buy shares and the ownership structure, corporations may be divided into three types (Matsger et al, 1992):

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- Corporations for profit,
- Corporations not for profit,and
- Government-owned corporations.

The types of for profit corporations and their characteristics are presented in table 3.

Table 3 - Types of For-Profit Corporations (Metzger et al., 1992)

	Publicly Held Corporations	**Close corporations**	
		Ordinary Close	**S Corporations**
Number of shareholders	Unlimited	Usually 50 or fewer	No more than 35
Officers and Directors	Professional managers	Most of the shareholders	Most of the shareholders
Number of Classes of Shares	Unlimited	Unlimited	Only one
Income Taxation	Double tax possibility	Double tax possibility	Only shareholders pay taxes

4. DEFINITION OF CORPORATE GOVERNANCE

The term 'corporate governance' refers to the legal rules, institutional arrangements, and practices that determine who controls business corporations, and who gets the benefits that flow from them. Corporate governance issues include how major policy decisions are made in business corporations, how various stakeholders can influence the process, which is held accountable for performance, and what performance standards are applied. The phrase corporate governance came into prominent use in the 1980s, and is often used narrowly to refer to the mechanisms and rules that govern relationships among direct corporate participants in publicly-traded firms, especially shareholders, directors, managers, and sometimes employees. But, historically, questions about social control over corporate behavior have been quite important. Since the corporate form first emerged as the dominant way to organize big business enterprises in the second half of the nineteenth century, policy concerns about corporations have, at various times, focused on antitrust, consumer protection, pollution control, worker and or investor protection, corporate involvement in the political process, and corporate contributions of resources to charitable causes (Smelser et al, 2004).

Different types of definitions on corporate governance are used by different authors, PRESENTED IN Table 4.

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TABLE 4 - CORPORATE GOVERNANCE DEFINITIONS

Author	Definition
Sternberg	Corporate governance is the process of supervision and control intended to ensure that Strongly agree the company's management acts in accordance with the interests of shareholders
Hess	Corporate governance is the process of control and administration of the company's capital and human resources in the interest of the owners of a company.
Schleifer,Vishny	Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment
Tricker	The governance role is not concerned with the running of the business of the company per se, but with giving overall direction to the enterprise, with overseeing and controlling the executive actions of management and with satisfying legitimate expectations of accountability and regulation by interests beyond the corporate boundaries
Cannon	The governance of an enterprise is the sum of those activities that make up the internal regulation of the business in compliance with the obligations placed on the firm by legislation, ownership and control. It incorporates the trusteeship of assets, their management and their deployment
Keasey, Wright	The structures, process, cultures and systems that engender the successful operation of the organization.

Even besides the obvious differences, all definitions include the element of the corporation's responsibility towards someone. From this point of view a few major types of definitions on corporate governance can be differentiated: definitions that emphasis the responsibility of the corporation towards its shareholders, definitions that emphasis the responsibility of the corporation towards its stakeholders and definition that emphasize the responsibility of the corporation towards the public in general.

The following aspects must be kept in mind while analyzing corporate governance (Bevir, 2007):

- First, which individuals or groups are provided with membership rights. Membership rights might only be given to one class of people. The shareholder system of corporate governance is probably the most prominent example of this approach within the corporate realm. In these organizations, membership rights are only provided to those who supply financial capital to the firm. Membership rights might alternatively be provided to more than one class of people or groups. In the corporate arena, these bodies are usually said to have a stakeholder system of corporate governance. Alongside shareholders, typical stakeholders include employees, members of the local population, representatives from supplier firms, customers, and local government.
- Second, it is valuable to examine the content of the rights provided to members. Two broad sets of rights are of significance here. On one hand, it is useful to focus on the precise character of the rights members enjoy over governance. For example, do members only have

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a right to be consulted about the direction of corporate policy or are they allowed to make decisions alongside managers? On the other hand, it is important to examine the rights over the surplus generated by the organization. Not-for-profit companies do not permit any part of the surplus to be distributed to members. For-profit firms are allowed to distribute the surplus to members, usually in the form of dividend payments.

- Third, it is useful to study the modes of representation available to members. Direct representation might be used to represent members' interests. Members might vote directly for a representative on the board of governors. Indirect representation occurs when organizations are used to represent members. For instance, a consumer council might be used to represent the views of customers. Proxy representation occurs when a self-appointed board is used to represent the stakeholder constituency.

5. IMPORTANCE OF CORPORATE GOVERNANCE

Good corporate governance helps to prevent corporate scandals, fraud, and potential civil and criminal liability of the organization. It is also good business. A good corporate governance image enhances the reputation of the organization and makes it more attractive to customers, investors, suppliers and, in the case of nonprofit organizations, contributors. There is some evidence that good corporate governance produces direct economic benefit to the organization. One study, conducted at Georgia State University and published in December 2004, found that public companies with independent boards of directors have higher returns on equity, higher profit margins, larger dividend yields, and larger stock repurchases. This study was consistent with another study of 250 companies by the MIT Sloan School of Management which concluded that, on average, businesses with superior information technology (IT) governance practices generate 25 percent greater profits than firms with poor governance, given the same strategic objectives (Lipman et al., 2006).

Bolton, Becht and Roell (Bexht et al., 2002) identify six reasons for the increased importance of corporate governance in last few decades:

- The World-wide Privatization wave. Inevitably, the privatization wave has raised the issue of how the newly privatized corporations should be owned and controlled. In some countries, most notably the U.K., part of the agenda behind the massive privatization program was to attempt to recreate a form of "shareholder democracy". In other countries great care was given to ensure the transfer of control to large shareholders. The issues surrounding the choice of privatization method rekindled interest in governance issues.

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- Pension Funds and Active Investors. The growth in defined contribution pension plans has channeled an increasing fraction of household savings through mutual and pension funds and has created a constituency of investors that is large and powerful enough to be able to influence corporate governance.
- Mergers and Takeovers. The hostile takeover wave in the U.S. in the 1980s and in Europe in the 1990s, together with the recent merger wave, has also fuelled the public debate on corporate governance. The successful $199 billion cross-border hostile bid of Vodafone for Mannesmann in 2000 was the largest ever to take place in Europe. The recent hostile takeovers in Italy (Olivetti for Telecom Italia; Generali for INA) and in France (BNP-Paribas; Elf Aquitaine for Total Fina) have spectacularly shaken up the sleepy corporate world of continental Europe.
- Deregulation and Capital Market Integration. Corporate governance rules have been promoted in part as a way of protecting and encouraging foreign investment in Eastern Europe, Asia and other emerging markets. The greater integration of world capital markets (in particular in the European Union following the introduction of the Euro) and the growth in equity capital throughout the 1990s have also been a significant factor in rekindling interest in corporate governance issues.
- The 1998 Russia/East Asia/Brazil crisis. The East Asia crisis has highlighted the flimsy protections investors in emerging markets have and put the spotlight on the weak corporate governance practices in these markets. The crisis has also led to a reassessment of the Asian model of industrial organization and finance around highly centralized and hierarchical industrial groups controlled by management and large investors.
- Scandals and Failures at Major U.S. Corporations

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