

## **CORPORATE GOVERNANCE: THE IMPACTS ON THE FIRM VALUE**

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### **Abstract:**

*Corporate governance is the most discussed topic by academicians and researchers to prove its importance in the business world through highlighting the advantages of employing corporate governance in firms. One of the essential advantages is the firm's value, since it is considered as an important sign for the sustainable growth and summarizes the positive efforts achieved through best practices of corporate governance. In the Eastern Europe and Eastern Asia countries, the firms' values are increased positively and even the macro-economy has achieved growth since firms assure certain practices of corporate governance such as disclosure to investors and monitors mechanisms besides others such as ethic codes.*

**Key Words:** E-Government, E-Governance, E-citizens,  
E-Business, Triangle Relationship.

**JEL Classification:** M4, M2, M11

### **1. Introduction:**

The main issue in the financial markets is determined as a taxing problem and that influences the impediment capital allocation, which is named as an urgent problem to be solved in the financial markets. In accordance with that, to solve those issues there is a need for control mechanisms carefully designed to meet the interests of stakeholders. In their turn, these mechanisms enforce financial intermediaries and corporate governance to act as corporate monitors and in the meantime, these mechanisms summarize the information requested in financial markets. That is highly requested in emerging financial markets otherwise the issues in the financial markets keep affect the global investors negatively.

The researchers on this problem of information in financial markets propose that prevalence of it create a conducive environment for adapting debt markets rather than public equity markets and in somehow that assures privatization in emerging economy countries. Basically, equity investors own the residual on the company and in the light of that investors should fully recognize risks and opportunities in firms, but that requests unfortunately a comprehensive assessment over the activities of the firm. Here, the role of other institutions such as brokers and investment institutions; is requested, since they should provide certain information in the favor of investors. Therefore, the quality of information financial markets has a role in developing the financial market itself through facilitate making investors' decisions and attract global investors in the long term. In accordance with that, disclosure standards are spotted for a higher quality and foreign firms are suggested to disclose about operating performance and other activities related to corporate governance besides publishing governance structure, which are important to increase the firms' value (Klapper & Love; 2002).

The growing spot of new researchers provides evidence on the linkage among illegal activities, corporate governance and firm's value and performance. Investors' rights, protecting and the minority interests quarter the corporate governance structure; and they are related negatively to illegal activities and positively support the firms' value (Doige et.al; 2002). Definitely, inefficient governance structure associated with poor legal base increase investing risk in emerging markets through basically reducing firm's value (Klapper & Love; 2002). Besides these suggestions, Black, Jan and Kim (2003) measure the effects of governance structure over the firms' value of South Korea and they suggest corporate governance is a dynamic motivation that explains the growth of firm's value. Many authors propose that the impacts of agency cost engender by lack of transparency and reduce investing opportunities of firms. Thus, corporate governance and firm's value is examined through analyzing transparency issues due to investors' prospective.

Evidentially, the broad measures of corporate governance in a firm predict higher share prices in emerging financial markets, that fact is found in single-country such as Russia (Black; 2001) and in the United States of America (Gompers, Ishii & Metrick; 2003). Accordingly, an economically correlation between corporate governance and firm's value is determined. In Russia; firms were state owned and the labor market was stable till 1990s, and then privatization and poor governance made the firms' values at the minimum level until 2000, when new codes of corporate governance was issued to assure good governance practices and these codes are sustainability adapted. The result is; many Russian firms look for external

investors since their values are increased due to good practices of corporate governance.

## **2. International evidence: corporate governance and firm's value**

Corporate governance is related to the problems of agency theory: the separation of management and finance, and it proposes a fundamental question is that how investors assure that they get revenue on their investment. In the thesis of Berle and Means in 1932; *The Modern Corporation and Private Property*; describes clearly the issues of agency theory due to the modern business environment assuring the need for qualified managers in order to make good decisions that serve investors' interests. In the light of agency theory, good practices of corporate governance help to the firm's value to overcome in two possibilities; throughout increasing the shares' prices, less cash flow and more dividends (Jensen & Meckling; 1976). Besides that, the firm's value can be increased by good governance practices through reducing the cost of shareholders' monitoring and reducing the capital cost (Shleifer & Vishny; 1997), accordingly, the mechanisms of corporate governance that solve agency's conflicts; increase the firm's value (Bruno & Claessens; 2010). In order to know how corporate governance affects firm's value, the channels that connect corporate governance and firm's value must be determined and then a certain firm's behavior will be defined to explain this relationship. That work has done by Klapper and Love (2004) through an association between the credit Lyonnais Securities Asia (CLSA) governance index and firm profitability, and relates this index to the market value of a firm.

In accordance with that, corporate governance affects the firm's value through ownership structure, managerial group, and board of directors. The ownership structure is a core element in defining firm value; where managers and executives hold a small part of firm's equity and in the mean time shareholders are too dispersed to enstrengthen value maximization, besides that, firm's assets may be employed to benefit the interests of managers and executives rather than shareholders (Berle & Means; 1932). In other hand, more concentrated equity by managers and executives reduces the problems of agency theory but more likely reduce the firm value (Jensen & Meckling; 1976), in the light of that, market value has a positive relationship with management ownership.

Investors and related institutions mostly use agency theory to understand the relation between board of directors and firm value since the board of directors is an important control mechanism over the performance of managers and executives, therefore, the board is a framework of the agency theory to resolve agency problems (Fama & Jensen; 1983). The

board size is in a positive relationship with firm value, as it is big and firm value will be better in the financial market since the size of the board of directors affect positively the quality of firm decisions. But the size should not increase a limit that affect negatively on making decisions through extending procedures and allow chief of executive officer to enforce his power in the company to serve individual interests and that reduces the firm value (Jensen; 1993). Also due to Demsetz (1983), the diversity and outside of board are so important to empower the investors trust and increase the firm value in the financial market. The separation of responsibilities between chief executive officer and chairman is considered as an effective monitoring mechanism, otherwise, CEO will serve the interests of the chairman creating “CEO duality” which negatively affects on the firm value.

**Table 1 The Relationship Between Corporate Governance Variables and Firm Value**

Category	Variable	Relationship
Ownership Structure	Insider Share Ownership	+
Board Characteristics	Board Size	+ or —
	Board Diversity	+ or —
	Outside Directors Percentage	+ or —
	Board Meeting Frequency	+ or —
Managerial Group	CEO Duality	—
	Executive Compensation	+

Resource: Weiyang, Baofeng (2009)

The governance effectiveness bases on the application of corporate governance principles that serve stakeholders’ interests and assure transparency. The firm resources are used efficiently when good practice of corporate governance is applied. These practices help firms to attract low cost investment through enstrengthen the confident of investors and creditors (Gregory & Simms; 1999). Overall, that addes value on the firm and leads to serve the firm value in the financial market.

### **3. Governance evidence on firms:**

To prove the relationship between corporate governance and firm value; two firms are selected to highlight this relationship. Gazprom and Petrom since two companies were public owned during the communist period and become private companies during privatization period. Both companies adopt corporate governance and international accounting standards to enstrengthen the financial situation and take a part in the domestic and international petroleum market. Besides that, the ethic codes and local culture value is reflected in the board of directors; the below table explains the important points of Gazprom and Petrom governance models.

The Russian governance model characterized by an ownership structure with allowing to the state to play an important part in the management but the lack of shareholders protection leads to assure the importance of independent directors and to review the governance model in 2013. Gazprom takes the advantages of all these processes to become one of the leaders in the gaz market in Europe. On other hand , the Romanian governance model has been issued and adapted during the last two decades based on capitalism approach (Feleaga et al; 2011), European codes are mixed with local legitimated codes to formulate Petrom governance model.

	Gazprom	Petrom
<b>OECD principles</b>	Adopted	Adopted
<b>Governance model</b>	Single tier model	Double tier model
<b>BOD Members' citizens</b>	Russia, Former USSR (that returns to fact that Gazprom were presented as a national company, recently foreign capital takes a place in order to be listed in American Stock market)	European including Romania (that returns to fact that Petrom is a member of OMV group; majority of member of OMV are from Austria, and executive board's chief is Romanian)
<b>Education level</b>	Majority of members of board and committees carry PhD degree in economy and law, Aviation Institute	Majority of members of board and committees carry bachelor degree in economy and law, and MBA, Mechanical Engineering.
<b>Experiences</b>	Professors in universities, banks, Russian government, and related companies and institutions.	Banks, consultant, and related companies and institutions, Romanian government.
<b>Women's advancement</b>	5 members	1 member the CEO
<b>Ethics codes</b>	More reflect Russian values.	More reflect European-Austrian values and U.N
<b>State sharing percentage</b>	55.002% (other reason; codes reflects Russian value)	20.64% hold by Romanian Ministry of Economy
<b>Foreign sharing percentage</b>	26.955% (American Depository Receipt: ADR)	51.01% (OMV group)
<b>Accounting Standards</b>	IFRS	IFRS
<b>Remuneration</b>	Based on members' contracts and other health and social benefits based on members' performance.	Based on members' contracts, market and giving shares.
<b>Independence directors</b>	Acceptable level (state influence)	High level

Source: SALTAJI (2014)

Due to the stock market date, the following diagrams are issued



Source: Romanian Stock Market

<http://www.bvb.ro/FinancialInstruments/Details/FinancialInstrumentsDetails.aspx?s=SNP>

### OGZD PJSC GAZPROM



Resource: London Stock Marekt

<http://www.londonstockexchange.com/exchange/prices-and-markets/stocks/exchange-insight/trade-data.html?fourWayKey=US3682872078USUSDIOBE>

The above data decalcifies the fact that employing corporate governance in both companies serves firms value in the stock market with taking in our consideration that share price may decrease and increases due to certain issues such as political and market demand issues. The professional performance of executives and managers reflect the high education of them

and that returns positively on the firms' performance, besides that, the independence of BOD grants an efficient controlling over managers' activities and in the meantime it empowers the trust of foreign investors. In addition, the positive relationship between sustainability and corporate governance will be reflected on the firm value since investors are looking for stable companies that run activities in the long term.

**Conclusion:**

The article supports a positive correlation between firm value and corporate governance. Besides that, in the dynamic environment, corporate governance is significant for sustainability aiming firms to improve the financial operations and enjoy low capital cost besides new investors and clients. Stakeholder theory of corporate governance presents corporate social responsibilities, which are so important to protect and serve the public interest. The corporate responsibilities will reduce the conflicts between the internal and the external stakeholders, also, in the long term it will support the firm value in the stock market.

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