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CORPORATE GOVERNANCE IN DEVELOPING ECONOMIES: A CRITICAL REVIEW

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Abstract

Most firms in the Sub-Saharan Africa are collapsing as a result of poor corporate governance practices. The recent collapse of firms in both the financial and non-financial sectors in developing countries indicates that there are challenges faced by firms when it comes to corporate governance. This article aims to examine corporate governance in developing countries. The article uses empirical evidence in the identification of views on the key components of good corporate governance practices for listed firms which include: the board of directors; institutional characteristics; as well as the effects of external factor. The pertinent research question addressed by the article is: What are the components that are essential for good corporate governance of firms in developing countries. The research design adopted for the article was empirical review whereby previous research studies, publications and reports were reviewed to examine corporate governance practices in developing countries. The findings revealed that separation of the role between CEO and chairman (board duality) hinders corporate governance practices. Further, it was established that accounting systems in the developing countries plays a major role in promoting effective corporate governance practice. However, corruption, political environment, cultural and societal factors, and economic factors such as macro-economic policies may hinder the practice of good corporate governance. The article recommends the establishment of autonomous regulatory agencies and supervisory bodies free from any political/ government interference in the implementation of the Code and Guideline of corporate governance. The supervisory bodies and the regulatory agencies should be manned or managed by individuals of good character, trust and goodwill.

Keywords: Corporate governance, developing countries, firm ownership, regulatory framework, board composition

INTRODUCTION

Background to the Study

Globally, corporate governance has become a political debate. Corporate governance is in the forefront in many economies as a result of the vital role it plays in the overall health of economic systems (Carcello, Hermanson & Ye, 2011). The wave of U.S. corporate fraud in the 1990s was attributed to deficiencies in corporate governance. The global financial crisis between 2008-2009 triggered by the unprecedented failure of Lehman Brothers and the subprime mortgage problems, renewed interest in the role corporate governance plays in the financial sector. The development of a strong corporate governance framework in any economy is therefore key to the protection of shareholders, maintaining investor confidence in the transition countries and attracting foreign direct investment which can contribute to sustainable economic growth and development in the countries (World Bank, 2010). These developments have become instrumental in determining the levels of corporate governance, these include: the influence of investors or shareholders, the powers of the board, rules governing takeovers, international financial institutions, the global business environment and the compensation of the chief executives (Adams, & Mehran, 2005). Research on corporate governance span across various fields such strategic management, finance, political science and sociology.

Corporate Governance

The World Bank's definition of corporate governance is present in two different approaches. First, from the stand point of a corporation, emphasis is placed upon the existing relations between the management board, the owners and the stakeholders who include customers, investors, employees and communities. The main advantage in corporate governance is presented to the board and its ability to achieve a sustainable value by balancing the interests (Mulili & Wong, 2010). From the public policy point of view, corporate governance is defined as the provision for the development, growth and survival of a company and its accountability in the exercise of power and control over entities or companies. Public policy is mandated to discipline companies and business entities as well as ensure that they minimize differences between social and private interests (World Bank, 2010).

According to OECD (2009), corporate governance is the system by which business corporations are directed and controlled. The corporate governance structure outlines the distribution of responsibilities and rights among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and defines the rules and procedures for making corporate decisions. Through this, it also provides the structure for which the objectives of the company are set, and how to achieve the objectives and monitor performance." The OECD further presents a broader definition that: "…corporate governance refers to the private and public institutions, including accepted business practices as well as legal and regulatory frameworks which together govern the relationship, in a market economy, between corporate managers and entrepreneurs ('corporate insiders') on one hand, and those who invest their resources in corporations on the other hand" (OECD, 2009).

Corporate Governance in Developing Economies

In developed economies, corporate governance system has been gradually developed over several years, and currently, corporate governance can be seen as a complex mosaic comprising of legal framework, politics, professional associations, public institutions, regulations, and codes of ethics. In developing economies on the other hand, corporate governance is still on its development stages and much details of the mosaic are still missing (World Bank, 2010). Efforts aimed at the development of a system of good corporate governance in transitioning economies has been hindered by challenges which include weak legal and regulatory frameworks, weak institutions, under developed human resource capabilities as well as complex corporate ownership structures. In the transitioning economies, there are often-overlooked corporate governance problems (Rashid, 2009). These include:

1) The scope and validity of the definition,
2) The corporate governance framework,
3) The appropriate corporate governance model
4) The specific corporate governance settings

The business environment in the developing countries only favors the old corporation that have been in operation for several years, this does not allow healthy competition as new and young vibrant corporations are not able to entirely survive in the markets dues to various barriers. With the unpredictable economic conditions in the developing countries, managers of corporations consider their positions temporary and as such they are not willing to embrace corporate governance effectively hence they only maximize their benefits instead of the corporations and the key stakeholders (Rossouw, 2005). Weak government systems in the developing countries is also a hindrance in corporate governance since most policies being formulated have not been effective in streamlining corporate governance. The missing element in the context of corporate governance in developing economies is the lack of effective institutions associated with successful market economies (Rashid, 2009). However, other determinants of corporate governance in developing countries especially in the Global South are still not well understood warranting a closer examination.

Research Objectives

a) To examine the influence of board composition on corporate governance in developing countries
b) To determine the influence of macro-economic policies on corporate governance in developing countries
c) To establish the influence of firm ownership on corporate governance in developing countries
d) To establish the influence of regulatory framework on corporate governance in developing countries

LITERATURE REVIEW

The Importance of Corporate Governance for Developing Economies

A strong corporate governance foundation is critical for any developing economy. Strong corporate governance must comprise of applicable laws as well as checks and balances, sound financial and accounting practices as well as corporate practices that are in line with the international standards. The legal framework must be clear, timely and consistently enforced. Establishing effective corporate governance is of particular importance for developing countries since its success not only important for the growth of a healthy corporate sector but also for sustaining a healthy market economy (Tricker, 2010).

The recent experience of countries in transition shows that the assumption that a strong system of corporate governance will appear automatically as a result of ownership transformation is unrealistic. Even in developed market economies, differences in the ownership structure and level of concentration or dispersion of owners influence the selection and adjustment of corporate control mechanisms. For the countries in transition, the problem of good corporate governance development becomes more complicated due to the underdeveloped institutional infrastructure. For this reason, there is a need for a careful approach to governance restructuring so that a private sector can be formed, powerful enough to realize successful economic transformations towards a market economy.

According to Babic (2000), the importance of sound corporate governance for transition economies can be explained through its four main influences which include:

a) Creation of the key institution, the private corporation, which drives the successful economic transformation to a market based economy
b) Effective allocation of capital and development of financial markets,
c) Attracting foreign investment and
d) Making a contribution to the process of national development

To develop effective corporate governance, there is a demand for the establishment of certain market economy institutions that are necessary for economic growth. Corporates cannot achieve their goals and missions of making profits as well as improving the social welfare without good corporate governance. Without regulations of governance and the institutional support or without the acceptance of corporate governance culture among owner, managers and stakeholders, corporate entities cannot operate successfully (Eulerich, Theis, Velte & Stiglbauer, 2013). For developing countries, corporate entities and associated instructions are key drivers of successful economic transformation towards a market economy. As such, well developed corporate governance requires that all the relevant actors understand and recognize their roles in achieving good corporate governance. Increased privatization results to a high proportion of inactive participants in ownership since they do not recognize their responsibilities and rights. Majority simply wait for dividend payments which are not worth their value (Rashid, 2009).

Managers do not have a clear understanding of their roles as agents whey a comparison is made to the owners, but the managers tend to run the entities as their own satisfying their own interest at the disadvantage of the owners and the corporate entity as a whole (Bhagat & Black, 2002). Strict and coherent legal regulations are required for good corporate governance which demands an urgent consideration by policy makers in the developing countries. Further, it is important to provide for systems to recruit, train and reward professional managers who can be held to high standards of competency, ethics, and responsibility. Financing and investments are directly linked to corporate governance. Disciplining managers through corporate governance mechanisms leads to an efficient allocation of resources (Hermalin & Weisbach, 2014). For developing countries, it is doubly important: the scarcity of domestic savings demands that capital be allocated to the most profitable corporate entities, which is possible only if principles of corporate governance are given publicity, transparency and monitoring; in addition, due to the imperfection of market mechanisms (underdeveloped stock and bond markets and an ineffective banking system), corporate governance presents an additional mechanism for discipline and effective management control in corporations.

Current corporate governance settings in developing countries

In developing countries, the corporate sector is made up of “instant corporations” formed as the result of mass privatization; these corporations lack the simultaneous development of legal and institutional framework necessary for operations in a competitive market economy. Under these circumstances of diffuse ownership, insiders are able to strip assets and leave little value for minority shareholders (Rashid, 2009). Despite this almost all the corporate entities have effective boards, professional managers as well as components necessary for modern corporate governance. The regulatory framework, enforcement, shareholders' rights, disclosure and transparency and ownership concentration are institutional characteristics influencing the effectiveness of corporate governance in developing countries. Consequently, it is argued that for any developing economy, successful implementation of economic policy such as corporate governance is determined by the effectiveness of relevant institutional bodies such as the Central Bank, the Securities Exchange Authorities, as well as the bodies concerned with the regulatory and enforcement of corporate governance practices (Okeahalam & Akinboade, 2003). As a result, if rules and regulations, enforcement, disclosure and transparency, shareholder's rights and ownership concentration are not well implemented the corporate governance system (such as rules, laws, power, resources and authority of supervisory and enforcement agencies) will be affected. The structure and organization of legislature and competency of the regulatory and enforcement agencies are also affected.

Various studies have been conducted on corporate governance in developing countries especially within the Sub Saharan Africa. Scholars like Ayogu (2001) focuses on regulation, legalities and governance practices. Okeahalam and Akinbode (2003) expand the study of Ayogu (2001). Another study conducted by Okike (2007) examined corporate governance the status quo, Rossouw (2005) considered business ethic. Burton et al. (2012) and Okpara (2010) explored the framework of corporate governance. These studies are not detailed and are narrow in scope. This article attempts to fill the existing gap by using empirical evidence to identify views about the significance of each component (institutional characteristic of corporate governance such as regulatory frame work, shareholders' rights, enforcement and monitoring, ownership concentration, disclosure and transparency).

Scandals relating to corporate governance in developing countries have been as a result of mismanagement of funds leading to the collapse of some firms and the cause of failure have been traced to the board of directors who are key players in the corporate scene. Their responsibilities as a result have been strengthened by corporate governance reform resulting from the global corporate failures (Van den Berghe & Leveran, 2007). In South Africa for instance, the King Reports II and III published in 1994 and 2010 respectively addressed the issue of firms' board of directors. Additionally, in Nigeria, the code of best practice of corporate governance was issued in 2003 and 2011 by Securities and Exchange Commission (SEC) while the code of corporate governance for banking industry was issued by Central Bank of Nigeria (CBN) in 2006. These codes outlined the responsibilities of the board of director for both financial and non-financial firms listed in Nigeria Security Exchange. In Ghana, Securities

Exchange Commission issued corporate governance guidelines on best practice in 2009 focusing on the importance of the board of directors for listed firms in Ghana.

From the heart of corporate governance debate, Dennis and McConnell (2003) argues that the board of directors are internal governance mechanism with the mandate of representing shareholders' interest, where they have the authority to hire, fire, and monitor and compensate management. This makes the board of directors an effective corporate governance mechanism. According to Cadbury (1999) the board of directors serves as a bridge between shareholders who provide capital and the management who are in charge of running the affairs of firms. In a study by Van den Berghe and Leveran (2007), it was established that the board of directors guards of shareholders' interest. Thus the board of directors is still being opposed for the failure in undertaking their role and responsibilities in firms. Also, according to OECD (2004), board of directors is the main organ responsible for establishing and enforcing the mechanisms for corporate governance within the firms. Beside this, Hermalin and Weisbach (2014) argues that the boards of directors are economic institutions that satisfy various regulatory requirements. This economic function is determined by the difficulties within their firms.

For most developing countries, research indicates that corporate governance is influenced by the political, socio-cultural, economic and corruption. These embody the political economic, legal institution, social and technology influence and the ethical disposition of listed firms (Amaeshi, & Amao, 2009). In any developing country with weak corporate governance system, the level of corrupt practices by the management will be high including cases of insider abuse as well as mismanagement funds. The corporate governance system or environment determines the context for the assessment firm performance and corporate strategy in a country. The codes of best practice of corporate governance, guidelines for the practice of corporate governance and the King Report code of corporate governance were established as instruments for safeguarding listed firms against corrupt practices as well as mismanagement in corporate entities. They were also intended to promote accountability, transparency, social development and economic growth (Okeahalam, & Akinboade, 2003). Despite the implementation of these codes, guideline and the Report on corporate governance, several non-financial and financial in Sub-Saharan Africa Anglophone countries such as Ghana, Nigeria and South Africa have collapsed due to poor corporate governance.

Further, Chanda et al., (2017) found that understanding of corporate governance is at an embryonic stage in Zambia, but embedded corruption is likely to require addressing before any meaningful change is likely. A range of isomorphic forces appear to be prevalent which the study argues that root and branch change in structures and attitudes is a necessity if improvements are to be forthcoming. In Uganda, Wanyama et al., (2009) found that pervasive corruption and weaknesses in underlying frameworks have hampered attempts to improve practice. The results indicate that the mere emergence of detailed governance codes in developing countries does not necessarily mean that de facto practices will improve. Theoretically, the results suggest that corporate governance standards in developing countries may appear on paper to be broadly similar to those in developed countries. However, a widespread perception exists that Ugandan frameworks are not yet strong enough to support what might normally be considered to be “good” practice. Sound corporate governance is seen as being a multi-faceted notion, with a range of political and social frameworks requiring strengthening before meaningful improvements can be made. Thus, Wanyama et al., (2009) concludes that attempts to improve governance standards in a particular nation require more than the simple publication of codes of best practice. Root and branch changes in a wide-range of contextual factors, including at political and cultural levels, are required to provide the conditions in which meaningful improvements in corporate governance will occur.

MATERIALS AND METHODS

This was a secondary research which adopted carried out through systematic desktop review of literature pertaining to corporate governance in developing counties. The reviews focused on previous research studies conducted on corporate governance in developing countries in the global south specifically Sub-Sahara African countries. The empirical review focused on studies done in East Africa, West Africa as well as South Africa. Further, reports and publications on corporate governance in developing countries were examined and reviewed.

FINDINGS

The following are the key findings:

a) Enforcement, disclosure, transparency and regulatory frameworks may be necessary to improve corporate governance practice in developing countries.
b) Commitment of board members of firms to disclosure and communication may provide effective corporate governance practice in developing countries.
c) Board duality (i.e the separation of role between chairman and CEO) hinders corporate governance practices.
d) In the developing countries, accounting system plays a major role in the promotion of sound corporate governance practice. However, the political environment, societal and cultural factor, corruption, and economic factors such as macro-economic policies hinder effective corporate governance practices.

DISCUSSIONS

Regulatory Framework

It was established that the influence by politicians has a negative significant effect on the laws and regulatory framework guiding corporate governance. This finding implies that politician interfere with regulatory bodies and supervisory agencies responsible for monitoring and enforcement of corporate governance guideline and regulation of firms in developing countries. This may not allow regulatory bodies and supervisory agencies to have free hand in carrying out their roles. This finding supports recent evidence in Nigeria when guidelines and regulations for acquisition and merges were not followed leading crisis in Nigerian Securities Exchange Commission (NSEC).

Board of Directors

The study established that the board's commitment b to transparency in board nomination and election process lacks in the developing countries hence hindering effective corporate governance practice. Board duality (separation of role between the chairman and CEO) was also found to be a factor hindering corporate governance practices. This finding may be due to incompetence and inefficiency of both the chairman and CEO. This evidence implies that there may be separation of roles and responsibilities between the Chairman and Chief Executive officer. However, this is less likely to promote good corporate governance practice.

The attention to executive compensation by board members was established to influence rules and laws of corporate governance of firms negatively. This finding seem to be regard as absence of an executive compensation committee and this may give opportunity for the directors to award themselves compensation which is not in the good interest of the shareholders. Additionally, it is evident that commitment of board to transparency in board nomination and election process, board disclosure and communication increase the quality of corporate governance regulations. These two variables have a positive significant effect on rules and laws of corporate governance, power and authority of the regulatory agencies of corporate governance. This result suggests that the formal and transparency board nomination process, and board disclosure and communication significantly promote good corporate governance.

Firm ownership

Firm ownership was found to be a factor influencing corporate governance in developing countries, for instance it was found that in firms where the government owns majority of shares, there was a negative impact on rules and laws that guide corporate governance practice. This result may be consistent with the recent happenings in Nigeria where top government officials and politician are using their veto power to acquire shares in the selling of state-owned companies. At the end of the day they dictate and control the management and directors on the operations of the firms thus hindering the rules and laws guiding corporate governance of firms in Nigeria.

It was established that when the majority shareholders are board members and senior management, a negative significant effect on regulatory framework occurs. This implies that minority shareholders who are not members of the board and in senior management may not execute their rights in the firms. The regulatory framework may also be weakened if the when board members and senior management are majority shareholders thus weakening the rules and laws promoting corporate governance practice due to veto power in all their decision which may affect the rights of minority shareholders.

Furthermore, preferential treatment given to majority shareholders may hinder corporate governance in firms operating in developing countries thus, ownership concentration is prevalent and therefore there is likely to be preferential treatment for the majority shareholders. This finding is consistent with that La Portal (1997) who established that the majority shareholders have outright control of firms and they manage with higher percentage of ownership. This result suggests that the controlling owner of a firm will not agree to dilute their ownership, and this is generally known as non-dilution of entrenchment (Claessens et.al 2002). This also implies that minority shareholders may not have the right of expressing s their individual views. Also, since the majority shareholders have preferential treatment over minority shareholders, they are able to exercise their power by matching significant control right with significant cash flow rights.

It was further established that multinational firms with foreign nationals as majority shareholders comply with the regulatory frameworks hence effective corporate governance across countries where such firms operates. Also, firms with family members as majority of shareholders are more likely to comply with the regulatory frameworks that promote corporate governance practice. This evidence support the effects of family-owned firms where by the family will follow the rules and laws that promote effective corporate governance in the management of the firms so that the firms will attract more investors so that the firms not collapse.

Financial Reporting

Financial reporting by firms in accordance to statutory and ethical obligation is likely to improve rules and laws promoting corporate governance practice. It was established that the preparation of financial information according to statutory and ethical obligation enhance the promotion of rules and laws that guides corporate governance practice. This result implies that in developing countries, the financial reporting in most firms is inadequate leading to poor corporate governance.

Macro-economic policies

The political influence on monetary and fiscal policies sin developing countries affects the corporate governance regulatory framework negatively. This implies that policies on government expenditure and money supply hinders the establishment of effective regulatory framework that can guide corporate governance practice in the developing countries due to improper implementation of the policies due to institutionalized socio-political corruption in the developing countries. This has weakened the regulatory framework for corporate governance practice in firms.

CONCLUSIONS

Corporate governance is critical for the effective operations of an economy's financial market resulting to efficient allocation of financial resources and is the key to economic growth. The efficient financial market itself needs to promote better practice of corporate governance, reinforcing market discipline for corporate managers. The global flow of capital enables corporate entities to tap sources of financing from a variety of investors. If developing countries intend to exploit the global capital markets as well as attract long-term capital, the countries must comply with the international corporate governance standards and guidelines. The level to which corporate entities apply basic principles for good corporate governance is a relevant factor for investment decisions as well. It is especially important when considering direct investments, which are beneficial to developing countries since they mean not only capital, but the transfer of skills, technology and professional know-how as well.

Although direct investors exercise a lot of control, they also pay considerable attention to the framework of corporate governance. They request adapting to the global standards (of transparency, accounting), in order not to be in an environment where local companies may externalize their costs by means of corruption and hidden government subsidies. Corporate governance is important for national development as it has a growing role in increasing the flow of financial capital to firms in developing economies. Equally important are the potential benefits of improved corporate governance for overcoming barriers to achieving sustained productivity growth, such as the actions of vested interest groups. Improved corporate governance, however, cannot be considered in isolation. In the financial sector, attention must also be given to measures to strengthen the banking sector, and a country's financial institutions as a whole. In the "real" sector, close attention must be given to competition policy and sector–specific regulatory reform (OECD, 2009).

FUTURE STUDIES

The study was not empirical in nature and as such, relied only on extant literature on the subject matter. Therefore, it is recommended that future studies should be done on corporate governance in specific country contexts where the New Public Management practices have been adopted like Kenya. Corporate governance should also be examined rigorously in the financial and industrial sectors in these countries.

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