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A literature review of corporate governance

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Abstract: Corporate governance is a set of rules, practices and laws that guide companies to operate in an ethical and responsible manner. In the process of corporate operations, shareholders and management make decisions and supervise through clear rules, procedures and structures. Modern corporate governance emphasizes separation of duties and effective supervision. The separation of duties within the company helps to prevent conflicts of interest and unethical behavior. Its core lies in the allocation of power and the coordination of interests, avoiding conflicts of interest between shareholders and management, thereby improving the financial performance and market competitiveness of the company. This article combs through a large number of corporate governance practice literature to find out the effectiveness of corporate governance mechanisms in companies and institutions. This article also looks at reducing agency problems through effective corporate governance mechanisms.
Keywords: *Corporate governance, Shareholders, Principal-agent theory.*

1. Introduction

Corporate governance structure can affect the acquisition and effective allocation of corporate resources. Good corporate governance can ensure the efficient use of resources and the optimization of strategic decisions, thereby enhancing the core competitiveness of the company.The need for corporate governance arises with the separation of ownership and control in modern joint-stock companies in the market economy. Corporate governance issues need to meet two prerequisites: joint-stock companies and the separation of ownership and control. The company must be a joint-stock company with a certain hierarchy and structure, and its decision-making, operation and management mechanisms conform to the general form of economic democracy. The nature of a joint-stock company determines that it needs an effective governance structure to coordinate the relationship between stakeholders. In addition, the emergence of corporate governance must also be based on the separation of ownership and control, that is, investors or shareholders are not completely consistent with the actual operators or managers. This separation leads to information asymmetry, and shareholders cannot fully control and supervise the behavior of managers.

2. Corporate Governance Literature Review

Since Berle and Means first raised the issue of corporate governance in 1932, domestic and foreign scholars have conducted in-depth discussions and research on this topic. Despite the rich research literature, a generally accepted and clear definition of the concept has not yet been formed. Although there are different definitions of corporate governance in academia, several basic characteristics of corporate governance can be identified: value creation, improvement of internal control systems, decentralization, transparency and accountability, and the relationship between management, the board of directors, shareholders and other stakeholders [1]. Property rights are the core foundation of a company, determining all the power and rights of the company and defining the boundaries of the company. Through property rights, company managers gain the legitimacy of controlling the company and the owner's claim to the residual. Corporate governance is the external manifestation of property rights control and an effective way for company owners to control the company and safeguard their own

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interests. Good institutions, especially guaranteed property rights, are crucial to economic growth and development [2].The emergence of corporate governance is an inherent necessity of the market economy, because the principal-agent relationship itself contains a contradictory relationship, implying that the interests of the principal and the agent are inconsistent: the actual controller (manager) of the company cannot fully comply with the will, ideas and interests of the company's owners. This conflict of interest is at the core of corporate governance issues, because managers may make decisions that are not in the interests of shareholders for their own benefit. Under the ever-changing market economy conditions, no contract can exhaust all possibilities. The incompleteness of the contract leads to the inevitability of the principal-agent contradiction, which in turn leads to corporate governance issues. The design of corporate governance structures and mechanisms aims to reduce the negative impact of this incompleteness and ensure the long-term healthy development of the company (Mulili & Wong, 2011).The corporate governance systems of various countries reflect the results of the country's political, social and economic struggles, rather than being based solely on efficiency considerations. Nevertheless, many studies in recent years have attempted to analyze whether there is a superior institutional arrangement or a set of best practices to achieve greater economic growth. Studies have shown that there is no single best practice, and what is important is to have institutions that are stable, legitimate and prevent extreme rent-seeking behavior [4]. From the perspective of purpose, corporate governance is clearly problem-oriented, directly targeting specific issues arising from the interaction between shareholders, boards of directors, senior executives and other stakeholders, thereby reducing agency costs. By analyzing the impact of corporate governance factors such as board structure, independence and ownership on agency costs, it is found that corporate governance plays an important role in optimizing agency costs [5]. The equity structure refers to the distribution of equity within the company, including the types of shareholders and their shareholding ratios. Major shareholders can include individuals, institutional investors, governments, and other enterprises [6]. Executive compensation refers to the compensation system for senior executives, including CEOs, CFOs and other senior executives. Executive compensation is an important part of corporate governance, aimed at attracting, motivating and retaining excellent management talent, while ensuring that management's actions are consistent with the interests of shareholders [7]. Executive compensation refers to the compensation system for senior executives, including CEOs, CFOs and other senior executives. Executive compensation is an important part of corporate governance, aimed at attracting, motivating and retaining excellent management talent, while ensuring that management's actions are consistent with the interests of shareholders [8]. Corporate governance involves a delicate balance between owners, boards, and managers to ensure the economic interests of the company. Globalization affects this balance, and international integration may lead to reduced investment in corporate governance and higher performance-based compensation for managers, which may weaken the welfare gains of globalization [9].

Corporate governance can be seen as a check and balance mechanism that balances the relationship between owners, the board of directors and senior management, achieving the company's economic interests in a dynamic balance of contradictions. This means that the corporate governance system needs to be based on mutual constraints and mutual cooperation to ensure that the rights and responsibilities of different stakeholders are properly balanced. Through this dynamic check and balance mechanism, the company can maintain efficient operations and sustainable growth in the process of responding to changes in the internal and external environment.Corporate governance research has increasingly emphasized the relationship between governance mechanisms (such as board structure, executive compensation, and ownership concentration) and firm performance. Scholars have explored the role of independent boards and diverse leadership in strengthening decision-making and reducing risk. Environmental, social, and governance (ESG) factors have become an integral part of governance discussions, with research highlighting the importance of sustainable practices and long-term value creation (Jensen & Roy, 2023). A key shift is the integration of digital governance, exploring how companies manage risks related to cybersecurity and data privacy, which have come into focus due to the rise of digital transformation (Parker et al., 2022). The role of ownership structure in shaping corporate strategy continues to receive attention, with research findings suggesting that concentrated

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ownership may bring advantages in terms of monitoring and corporate control, but also carry the risk of agency problems (Li et al., 2020). The impact of shareholder activism and the growing importance of institutional investors have also been widely studied, with some arguing that these groups have begun to influence corporate behavior beyond financial returns, driving better social and environmental practices (Ahuja & Sharma, 2021). Regulatory changes and their impact on governance practices are another focus, with significant policy shifts aimed at strengthening shareholder rights and executive pay disclosure (Santos & Prado, 2022).

3. Corporate Governance and Principal-Agent Theory Literature Perspective

The management of agency costs remains a core issue in corporate governance. conflicts between shareholders and management (agency costs of equity) and conflicts between management and creditors (agency costs of debt). The impact of board diversity on corporate decision-making and financial performance in the context of agency theory found that diversity helps improve decision-making efficiency and corporate performance [10]. The applicability of agency theory to entrepreneurial firms points out that traditional corporate governance theories need to be adapted in emerging and technology-driven business environments [11]. Independent directors play an important role in alleviating the principal-agent problem. Independent directors can effectively monitor management and ensure that its actions are in the best interests of shareholders (Fama & Jensen, 1983). Independent boards of directors and audit committees can significantly reduce corporate earnings management behavior, thereby effectively reducing agency costs [12].In modern corporate governance, the incentive mechanism of management is one of the keys to solving the agency problem. Through equity incentives, performance bonuses, and other means, managers' interests can be better aligned with those of shareholders [13].

The motivations of technology managers in mature R&D firms in making radical innovation decisions point out that corporate governance plays a key role in incentivizing and monitoring these innovative activities. The view that innovative firms can solve agency problems criticizes the inadequacy of traditional agency theory in explaining the predatory behavior of American firms and suggests replacing agency theory with innovation theory [14]. In an open innovation environment, companies can achieve collaboration and growth by overcoming organizational defense mechanisms [15]. Good corporate governance can promote disruptive innovation through high-incentive contracts, thereby improving overall productivity and welfare [16].The theory proposed by Jensen and Meckling in 1976 holds that through appropriate ownership structure and monitoring mechanisms, management can be motivated to maximize shareholder value. According to the principal-agent theory, when the interests of managers and shareholders are not aligned, managers may be more inclined to pursue short-term profits and ignore the need for long-term investment and green innovation. Research shows that good corporate governance can effectively reduce managers' short-sighted behavior and agency costs, thereby promoting companies' investment in green R&D and sustainable development. Research using the Tobin Q model shows that companies with stronger governance structures invest more in green R&D, and that for every 1 percentage point increase in governance scores, green R&D expenditures as a percentage of total assets increase by 0.77 percentage points [17]. Corporate ESG performance and social responsibility also have a significant impact on green innovation efficiency. Good ESG performance can improve corporate innovation efficiency and reduce financing constraints (Li, 2024).

4. Conclusion

This article reviews the research findings in the field of corporate governance, emphasizing the key role of effective corporate governance in improving organizational performance and ensuring long-term sustainable development. The core purpose of the article is to analyze the mechanisms of corporate governance, its operational efficiency, and its role in managing corporate operations. The main topics discussed include the separation of ownership and control, the principal-agent problem, and its far-reaching impact on corporate governance. Research generally shows that a sound corporate governance mechanism can effectively alleviate the contradiction between ownership and control, and clarify the division of responsibilities between shareholders and management. Through the analysis and discussion

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of existing literature, this article provides academic researchers and practitioners of corporate governance with a comprehensive overview of the principal-agent problem and the relationship between ownership and control.

5. Limitations of the Study

Due to time constraints, this paper was unable to delve into empirical research on corporate governance and lacked detailed analysis of actual data, which limited the comprehensive assessment of the effectiveness of corporate governance mechanisms. Although this paper emphasizes the importance of corporate governance at the theoretical level, its practical application in different business environments has not received sufficient attention. The effectiveness of corporate governance in different countries or regions may be affected by multiple factors such as cultural background, legal environment and market structure. Therefore, this paper does not fully consider the potential differences in the impact of different corporate natures on corporate governance structure and its impact on performance. For example, factors such as industry characteristics, enterprise size and ownership structure may have different effects on the effectiveness of corporate governance in different types of enterprises. Future research should pay more attention to these empirical investigations and further explore the impact of different cultural and corporate characteristics on corporate governance performance.

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