Corporate Governance, External Environment and Organizational Performance A Review of the Current Empirical and Theoretical Evidence

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ABSTRACT

The study aims to review and expand general understanding on the relationship between corporate governance, external environment and firm performance. The study is motivated by the current debate on strategic role of external environment in corporate governance on organizational performance relationship. Using narrative review as its guiding approach to draw themes and insights, the study examines empirical and theoretical literature that looked at the influence of the external environment on the relationship between corporate governance and organizational performance.

The study is anchored on three theories; the agency theory (Jensen and Meckling (1976), resource dependance theory (Pfeffer, & Salancik, 1978) and Resource based view (Birger Wernerfelt, 1984; Barney 1991). The agency theory, explains the relationship between the two key players of an organization, the principal, who is the owner, and the agent, who is the manager. The resource dependency theory suggests that the external environment holds resources which are needed by the organization to survive and that since an organization does not operate in a vacuum but in an environment, for it to succeed it must align its operations with the environment. In this paper focus is placed on external environment as one of the strategic resources which play a key role in the relationship between corporate governance and organizational performance. In conclusion, this paper postulates that external environment influences the relationships between corporate governance and organizational performance.

Keywords: corporate governance, external environment, organizational performance

INTRODUCTION

Organizational performance is of paramount importance to the shareholders and all other stakeholders of an organization, as observed by (Kafetzopoulos, Evangangelos & Dimitris, 2019). Consequently, a number of studies have been undertaken in an endeavor to understand why some organizations perform better than others. Strategic management studies have recognized that organizational performance as a complex phenomenon which can only be evaluated based on different measurement options and influencing factors (Sudaryati, 2020). Ronaghi and Mosakhani, (2022) hold the view that corporate governance can significantly explain the performance of most organizations, while the external environment and internal technology in an organization significantly influence the relationship between corporate governance and performance.

This study is anchored on the Agency theory because it links the relationship of organizational shareholders and agents who oversee the daily operations of all the organizational sector, which are key to organizational performance. The study is also supported by Resource Dependency Theory, which hypothesizes that the performance and survival of an organization is pegged to resources in the external environment and

organizational performance is dependent on its relationship with the external environment. This means that an organization's competitiveness is determined by the way it deals with its external resources (Van Weele, 2018). Nakpodia and Olan, (2022) argue that for an organization to survive it should align with its external environment. The organization is an open system that has a mutual interaction with its environment. Strong internal capabilities emanating from the organizational resources such as the people, technology and other assets enable adaptability and agility in relation to the external environment. This is a key plank in the Resource Based View (RBV), which holds that the possession of valuable and unique internal resources confers a competitive advantage to organizations that possess them.

Theoretical and empirical evidence show that organizational performance can be explained by the distinctive resources and capabilities of an organization, but variations in the performance of organizations are difficult to understand. Current trends in the empirical and theoretical research show a pervasive need to explore the variables that influence the relationship between corporate governance and performance of an organization. The study adds credence to current debate by reviewing existing theoretical and empirical literature with a view to creating a conceptual understanding of the influence of the external environment and internal technology on the relationship between corporate governance and organizational performance.

The rest of the paper is structured as follows: the conceptualization of the paper's key constructs including corporate governance, external environment and organizational performance is introduced; the theoretical foundations, highlighting the Agency Theory and Resource Dependency Theory; literature review of corporate governance and organizational performance, in the process delineating key themes and perspectives from the literature, as they relate to the relationship between corporate governance and external environment on the one hand and on the cumulative relationship between corporate governance, external environment, and organizational performance on the other; the research gaps summarizing discernible inconsistencies and contradictory viewpoints from the extant literature, and; conclusions.

Corporate Governance

The debate about corporate governance has largely advanced worldwide, and its concept is well covered by scholars, yet there is no unanimous understanding of what it entails as there are disparate interpretations. From the literature on corporate governance, it is evident that definitions of corporate governance vary considerably, with different schools and streams of thought. Cadbury (1992) defined corporate governance as a structure in which an organization is guarded and managed. The Organization of Economic Co-operation and Development (OECD) defines corporate governance as a structure by which organizations are led and managed. Fatima, Ishtiaq and Javed, (2021) argue that the first debate on corporate governance started as early as 1602 in the Netherlands. During this period, organizational management insisted on the perspective that productivity is realized as companies pursue their normal work. Other schools of thought hold that the corporate governance debate started with Adam Smith's thesis and the Wealth of Nations book. In his argument, Smith suggested the need for a robust tool to control and solve any struggle between the executive and the shareholders. This was because the management of someone else's wealth may not benefit from the care and thoughtfulness as that of the owner (Mutlu, Marc, Peng, Saleh & Patricio 2018). Another school of thought contends that the corporate governance debate began in early 1932 with Berle and Means. Berle and Mean (1932) maintain that there is a need for a monitoring mechanism for any possible gap between the organizational management and the shareholders (Ruparelia & Njuguna, 2016; Zuva & Zuva 2018).

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Based on the diverse and fragmented views of corporate governance, there is no agreed operationalization of corporate governance. Scholars have thus operationalized it based on the disciplinary domain, objective of the study, regional area the study is taken, the researcher worldview and the time the scholar has for the study. For instance, corporate governance research is conducted in the related yet distinct fields of management and finance, thereby leading to divergent operationalization, thereby lending credence to the notion that there is no consensus on how it should be applied. Despite the lack of convergence, corporate governance is still being applied by organizations by establishing different decisions and mechanisms on ow to make it work.

The mechanism adopted by firms and nations, therefore, determines the type of corporate governance developed and an effective mechanism by which its compliance will be substantiated (Castrillón, 2021). Initially, corporate governance focused on protecting the principal wealth from exploitation by the agent, but the debate has over time widened to include all stakeholders. Ana, Sulistiyo and Prasetyo, (2021) argue that failure of corporate governance affects not only the agent and principal but also all stakeholders of the organization such as employees, suppliers, customers and government.

Zuva and Zuva (2018) used boards of directors, managerial remuneration, committees, and independent directors. Zhou, Owusu and Maggina, (2018) use a board of directors and an audit committee. Ying, Tikuye and Shan, (2021) used board, ownership, audit, and transparency as the corporate governance mechanisms; Wu, Liang, and Zhang, (2021) used the Chief Executive Officer (CEO) duality and an independent director. In addition to the argument, Tjahjadi, Noorlailie and Febriani, (2021) brought in the CEO's education, Top Management Team (TMT) size, board size, and president of the board of committee, while Ramaiah, Jan, Chebolu, Arumugam, and Subramani (2019) focused on the size and formation of board, director compensation, and independence of the board, ownership structure, and diversity of the board as the corporate governance mechanisms.

Taken together, the different perspectives of corporate governance mean that it encompasses a myriad areas of interaction, including legal, regulatory, structural, management, ethical, and behavioral aspects. In this study corporate governance is defined as the leadership and management structure of an organization.

External Environment

The external environment is not the physical surroundings of an organization but all influences that affect its operations and performance. Ansoff, (1972) describes the external environment of an organization as a set of elements and their significant properties, in which the basics are not parts of the structure but a variation in any of them can produce a variation in the state of the system. The organization's existence exists in an environment both internal and external, as was grouped by Duncan, R.B (1972). The internal environment is one that a firm has control and is within the domain of its influence. By contrast, the organization has no influence over the external environment, making it more challenging to manage although it has implications for the organizational performance through the elements of threats, opportunities, and constraints and, therefore, affects organizational performance.

The organizational external environment tends to shape the outlook of an organization and its goals by placing constraints on them (Dan, Roxanne, Helm, Stevens, & Kipley. 2018). Organizational environments have been hypothesized in diverse ways, but most of them can be traced back to the work of Dess and Beard in 1984. The major ones are dynamic environments and environmental uncertainty. Lu and Wang (2021) emphasize that the external environment is either stable or discontinuous. In a steady environment, future pronouncements are based on past and present actions that can be extrapolated into the future. According to Valentinov (2022), the environmental turbulence concept was introduced by Emery and Trist in 1965. They indicated that any environment in which organizations operate is influenced by multiple component groups with different disruptive factors.

The changeability of the organizational external environment signifies the originality and promptness of variation within the organizational environment. While predictableness of a firm environment is the evaluation

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of clarity of an organization's information dealing with changes for strategic decision-making (Kipley, Stevens & Kipley, 2018), today's organizational environment is turbulent and uncertain. Van, Wojciech, Justyna and Segbotangni (2021) argue that globalization, technology, and internalization are the causes of volatile organizational external environments and dynamics, resulting in increased uncertainty for organizations. Scholar's attribute environmental uncertainty to lack of access to sufficient information. The key ingredients of today's environmental turbulence are the high knowledge intensity of firm activities, significant environmental task dynamism, and outcome interdependence.

The effectiveness of corporate governance and organizational relationships is not a linear relationship; thus, the relationship is influenced by numerous factors. Research in corporate governance shows that external environments influence relationships (Fermando 2017). Organization is an open system; it gives and receives from the environment; hence, the environment is a key factor in organizational performance. The environment affects organizational decisions, strategies, processes, and performance. Tang and Wang (2017) denote that the external environment affects the relationship between corporate and organizational performance. Thus, external environmental uncertainty has a negative implication for corporate governance and organizational performance. Solikhah and Maulina (2021) affirm that uncertainty in the external environment increases operations expenses and hence lowers organizational performance. According to Castrillon (2021), corporate governance that is aligned with the environment, not only guarantees returns of the shareholders, but signals to current and potential shareholders the prospects of recouping their investment is high.

Organizational Performance

Organizational performance is the degree to which a firm makes efficient and effective use of its resources to satisfy its stakeholders and attain its objectives (Sheila, 2016). Organizational performance is the primary degree of a firm's outcome and is influenced by both internal and external factors. Kafetzopoulos et al., (2019) define organizational performance as the ability of an organization to attain the intended outcome in relation to set objectives and goals. The ultimate measure of a firm's results is its performance and its influence on numerous market contingencies and the organizational environment, both internal and external. Organizational performance can be viewed through several factors, such as financial performance, which includes profit and return on assets, shareholder return, and customer satisfaction.

Kafetzopoulos et al. (2019) mention that organizational performance is grouped into two categories: financial performance and market performance. Market performance is the degree to which a firm gains new customers and retains them for its goods and services, while financial performance is the degree to which an organization accomplishes a monetary outcome, all viewed a variety of success indicators. In agreement with Kafetzopoulos (2019), Sudaryati (2020) posits that it is important for any organization to measure its performance, equally underlining the centrality of financial measures as well as other performance parameters such as quality, flexibility, resource utilization, and innovation.

The type of organizational performance measurement can similarly be organization specific, subject to internal policies. The literature clearly shows that the organizational performance debate should pay attention to the basics, including the size and the complexity of the organization. For example, the performance of small organizations is quite different from that of larger organizations. Purwanto's (2020) maintains that an organization has a lot of dimensions, but economists usually focus on three aspects, which are efficiency, technology development, and balance in distribution. Theoretical and empirical evidence on the relationship between corporate governance and organizational performance demonstrates that improved corporate governance increases organizational performance. However, the differing viewpoints with respect to the link between corporate governance and organizational performance inform divergent outcomes Alabdullah (2016). This implies that significant gaps still exist in making sense of the relationship between corporate governance and organizational regardless of the numerous research done on the subject.

According to Adedeji et al., (2020), the current organizational performance points to the trend to make financial statements, the ultimate basis to measure organizational performance, which may not make an appropriate and

suitable assessment of performance. The new debate points to the adoption of financial and nonfinancial dimensions for determining organizational performance. Sheila (2016) argues that organizational performance is attainable only if there is an effective progression of uninterrupted operations, which is the ability of an organization to utilize its resources efficiently and to produce results that are consistent with goals and objectives. Therefore, when an organization has satisfied the interests of all stakeholders and shareholders, it can be measured as successful.

Theoretical Foundation

This section presents the theoretical foundation for corporate governance and organizational performance. Despite the existence of numerous theories to support corporate governance and organizational performance, this study chose to focus on three theories based on the study variables. These theories are: the Agency theory, Resource-Based View theory, and resource dependency theory. The agency theory addresses the relationship of the key players of the corporate governance, resource-based view emphases on the internal resources which gives an organization competitive advantage while resource dependency theory explains how organizational performance is affected by external resources. Thus, all these theories are deliberated in light of the conceptual study variables.

Agency Theory

Agency theory originates from the economic field. Jesuka and Peixoto, (2022) argue that agency theory is an economic theory that views the organization as a set of agreements among self-centered people. Stephen Ross (1973) and Barry Mitnick (1975) independently proposed the agency theory which was advanced by Jensen and Meckling in 1976 and later expanded by Tosi and Gomez-Mejia in 1994 (Hien and Hai 2020). However, the agency problem can be traced back to the era of Smith who pointed out that a negative correlation would manifest when there is a conflict between the executives in the agency problem and the investors, who are the shareholders today (Jesuka and Peixoto, (2022). Based on Jensen and Meckling, an agency relationship refers to an agreement where owners of a firm hire the firm's directors to execute certain services on their behalf, such as decision-making power. The agency theory was established based on two key behavioural assumptions. One of these two assumptions is that individuals seek to maximize their utility while the other assumption presumes that individuals are likely to benefit from the incompleteness of contracts.

Comparably, Jesuka and Peixoto, (2022) state that agency theory focuses on solving agent challenges that arise when shareholders' and managers' expectations and attitudes towards risk conflict. The theory assumes that people are generally egoists and they act in their own best interests and that agents have access to more information and ordinarily have a better decision-making capacity. The managers' interests can be managed by providing appropriate incentives, while monitoring can help limit the manager's opportunistic actions. Agency theory focuses on the maximization of shareholder benefits and returns (Houqe et al. 2019). Hien and Hai, (2020) maintain that shareholders cannot determine the accuracy of the information submitted to them and the business moves undertaken by the agent. Therefore, the shareholders can't be sure that the agent is working in their favor. To counter that, compensation of the agent may be linked to the achievement of the shareholders' main goals (Terziev & Klimuk, 2021).

Agency theory has been critiqued for its focus on only conflict between the principals and agents, when in reality there are various other conflicts in an organization that are themselves connected to the variety of categories of contracts and delegations that now exist. That includes the conflict between shareholders and creditors, franchisor and franchisee, and majority and minority shareholders. Additionally, agency theory has been criticized for being unsuitable for social life due to its assumption that the actors are self-interested and indivisible. That is, the behaviors are motivated solely by personal fiscal interests. Agency theory has been critiqued for its assumption that behaviors and consequences are relatively homogeneous and can definitely be managed, which is not the case in the current world. These criticisms notwithstanding, Houqe et al. (2019) emphasized that although corporate governance and organizational performance are viewed from numerous theoretical perspectives, agency theory still remains the dominant theory.

Resource Dependency Theory

The Resource Dependency Theory (RDT) was developed by Pfeffer and Gerald in the 1970s (Nakpodia and Olan, 2022). The abundance of resources around the organization, its importance, and who controls it are fundamental factors in building RDT. Resource dependency theory affirms that an organization depends on its environment for survival. Nakpodia, and Olan (2022) argue that for an organization to survive, it should align with and fit into its external environment. The organization is an open system that gives and receives from the environment. The effectiveness of corporate governance practices enables an organization to benefit from external environmental resources. RDT assumes that organizations must engage in transactions with their environment in order to acquire resources. No organization is self-sufficient; by necessity, all of them engage in processes of exchange with other entities around them.

Dalwai and Mohammadi (2020) point out that the external environment holds key resources for organizations and must align their operations through governance, if they have to benefit from it. While the resource-based view concentrates on the internal resources and capabilities, the resource dependency theory focuses on the external resources (Isaac, 2022; Castrillón, 2021; Nakpodia & Olan, 2022). RDT has been critiqued for focusing more on the material part of the environment, in effect downplaying the imperative to embed environmental demands arising from values and behaviors within society.

Literature review corporate governance and organizational performance

Corporate governance debate has reached a level of maturity where a review of the prior literature can help to consolidate the achievement of the field and craft a research agenda for future research. Corporate governance and organizational performance debate have grown and there has a large body of literature published both in the field of strategic management and finance (Li 2021). The literature highlights the existence of significant relationships that are associated with the mechanisms of corporate governance and the variety of factors that lead to different results observed from those relationships (Alabdullah, 2016). Today, corporate governance and organizational performance relationships are not only for the shareholders' benefit, but for the general enhancement of the economy of a state, a continent and the world at-large (Castrillón, 2021). For that reason, debate has been the subject of discussion by academics, regulators and practitioners both in developed and developing countries.

In the debate, some consensus has emerged regarding effective governance mechanisms in improving organizational performance, with countless guidelines implemented to enhance corporate governance and management practices (Gordon et al., 2021). However, there is evidence of mixed regarding the hypothesis that better corporate governance result in enhanced organizational performance. Furthermore, the available literature offers a range of plausible explanations for the mixed results, such as the variable used, research method used, the time and environment of the research.

Corporate Governance and External Environment

According to Sudaryati (2020), the relationship between corporate governance and organizational performance is not a linear. Rather, it is influenced by various variables, both internal and external factors. Darvishmotevali et al., (2020) supports the argument of bringing in the external environment. They argue that the external environment is one of the key variables that influence corporate governance and organizational performance relationships. In addition, Bendickson et al., (2018) opined that external environmental uncertainty has negative effects on corporate governance and organizational performance relationships. The uncertainty of the external environment forces an organization to use a lot of its resources to deal with the changes. Sudaryati, (2020) affirms that the uncertainty of the external environment increases operational expenses, hence lowering organizational performance. That means for corporate governance and organizational performance to be effective, the external environment should be considered, in addition to the internal issues such as size of board members, audit committee, independence of board, transparency of accounting (Kipley et al., 2018).

Prior studies have stressed the significance role of the external environment on corporate governance and organizational performance. Sudaryati, (2020) argued that institutional ownership as an organ of corporate governance offers oversight to the top management team about excessive use of organizational resources in a time of great external uncertainty. The owners' efforts through the use of effective technology result in better operational efficiency, in the process increasing the organization's performance. Kafetzopoulos et al., (2019) argue that environment theorists, Duncan, R.B (1972), Ansoff and Mc Donnell (1990) and Ansoff and Sullivan (1993), emphasize that for organizations to survive and be competitive, they must adapt to their environment.

Corporate Governance, External Environment and Organizational Performance

It is worthwhile noting that nearly every relationship among variables in research has a moderator though they are not always measured. The idea of analytically combining moderation and mediation in research is not new. This paper paid attention to the moderating and mediating effect of internal technology and the external environment on corporate governance and organizational performance relationships (Owuori et al., 2021). While Picciau, (2020) and Ronaghi and Mosakhani, (2022) further note that technology plays a significant role in facilitating more reliable and accessible information by the shareholders and all other stakeholders, hence empowering them in their governance role and evaluation of organizational performance.

Prior research emphasized that external environments influence how the organizational resources will be used. There are more resources channeled to dealing with environmental uncertainty, without which there would be the risk of unsatisfactory performance. Sudaryati (2020) argues that the external environment combined with internal technology results in effective corporate governance and a company’s performance. Change in the external environment creates environmental uncertainty in the organization, hence pressure for the organization leadership to sustain and improve performance (Sudaryati, 2020; Anik et al., 2021). On the other hand, the external environmental pressure could lead to negative governance transactions such as manipulation of account reports, corruption and unlawful third-party transactions (Picciau 2020)

The complexity and challenges that organizations go through internally and externally makes corporate governance essential. When implemented well, it reduces the conflict between the shareholders and agents. As a result, organizational stakeholders such as external interested parties, governments, investors pay more attention to corporate governance. This has been occasioned by the experience of large-scale companies failing to implement corporate governance and the resultant implications for performance (Khairiyani 2018). Furthermore, Ana et al (2021) affirm that good corporate governance practices help internal organs in building healthy relationships. It is a pre-condition that the organization finds a fit between the internal technology, operations systems and the environment in which it operates for the implementation corporate governance in order to performance.

Ana et al., (2021) noted that organizational success and its continuity in winning the present and future competition will mostly be influenced by strategic organization resources such as the skills and competence of corporate governance players, employees, solid customer relationships and technology. According to Kanashiro and Rivera (2019), response to the influence of the external environmental relationship on a firm’s performance will be determined by organizational strategic resources in play.

Research Gaps

The literature shows that findings from different researchers vary. A good number of studies done show a positive significant relationship between corporate governance and organizational performance. These studies do not point out the mediating and moderating factors that led to this kind of relationship. Other studies show negative relationships, while others present mixed, inconsistent results. It is also worth noting that different performance measures were used to measure organizational performance and this has led to differing findings as stated in the existing literature. There is a need to establish an appropriate measure of organizational performance. The findings of various empirical studies are not consistent, hence lack consensus written on how corporate governance and organizational performance relate. Lu and Wang (2021), Kyere and Ausloos (2021) found a

positive and significant relationship in corporate governance and performance of an organization, while Nugroho (2021), and Anik, Anis and Jaka (2021) found negative and no significant relationships. The empirical role played by corporate governance in various studies is not the same. That is because the empirical role played by corporate governance is not universal.

Apart from independent and dependent corporate governance operationalization, other scholars have operationalized corporate governance as a mediating and moderating variable (Owuori et al, 2021; Enrico et al, 2022). Additionally, there is no universal measurement of corporate governance. Different research uses different approaches to measure corporate governance. Khatib and Nour, (2021), Ali et al., (2022) used organizational performance as the measure of corporate governance. Olayinka, (2022), Tjahjadi et al. (2021) used sustainability as a measure of corporate governance. Rubino and Napoli, (2020) measured corporate governance with organizational environmental performance.

CONCLUSIONS

The study adopted a narrative review approach in conducting empirical and theoretical literature reviews on corporate governance and performance Based on literature reviewed, this study confirms that corporate governance and organizational performance relationships are not linear, but are influenced by distinct factors, both internal and external. In support of Resource Dependency Theory, the external environment is an essential factor in the effective relationship between corporate governance and the performance of an organization.

At the same time, a number of misaligned and contradictory findings can be discerned from the literature with respect to the relationship between corporate governance and organizational performance. Some research outputs point at a positive significant relationship. Conversely, others conclude that there’s a negative relationship. Between these two ends of the spectrum are those studies whose findings offer mixed results. As pertains to the latter category, the inconsistencies are attributable to a number of factors. The first is the conceptualization of governance as a study construct, as a moderating, mediating, or independent variable. The second factor is the varying interpretation of what constitutes organizational performance and, as a consequence, relevant measures.

In support of RBV, strategic resources influence corporate governance and organizational performance relationships and should be given attention. In the literature review, corporate governance on its own does not result in performance but lays out structure and strategies to how strategic resources such as effective internal technology carry through all practices such as auditing, board meetings, communication and accounting and efficiency decision making for the organization, resulting in a significant relationship between corporate governance and organizational performance. Houqe et al. (2019) examined the role of information communication technology in corporate governance mechanisms across countries and found that the effect of information communication technology on corporate governance and performance is different in more competitive and less competitive industries but revealed that the combined variables are major determinants. Thus, technology in corporate governance is an inevitable trend in the twenty-first century.

This study concludes that Agency Theory and Resource Based Theory are the main theories that describe the relationship between Corporate Governance and Organizational Performance, considering the external environment as control variables. In addition, this study concludes that corporate governance and organizational performance have a significant relationship.

Implication Of Study

Shareholders and the agent will use the report in designing an effective corporate governance mechanism for great organizational performance. The report will make the shareholders rethink the corporate governance they have been using and how to upgrade the overall change to the most effective one for the benefit of not only the shareholders but all stakeholders. The study will influence the shareholders to give a lot of attention to internal technology and other strategic resources for effective and efficiency of the operations of their organizations, hence better performance. The shareholder will not only focus on their relationship with agents, formation of on

the board, and remuneration of the chief executive officer but also, on the external environment and on the technology in management, operations and governance.

Governments and policymakers will have a better understanding of the corporate governance models in use by different organizations. This will help policymakers both locally and internationally to broaden their mindset towards corporate governance and rethink it in line with internal technology and the external environment, which were not given much attention in previous and current policies in corporate governance. The study agrees with previous studies that the relationship of corporate governance and organizational performance is not linear but influenced by numerous factors. This study brings into the corporate governance and organizational performance debate the organizational external environment.

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