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The Test of Corporate Governance System in the Electric Utilities Industry

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Abstract

The main purpose of this study is to test whether corporate governance is a system or not. Seven hypotheses are formed to reach this objective. The existence of significant relationships among three dimenisons (principles, processes and business results) is the main theme in these hypotheses. Regression analysis and reliability analysis are used in the study. 74 world's biggest companies in electric utilities industry are used in the sample of the study. Corporate governance, sustainability and corporate social responsibility reports of these 74 companies are coded with 34 variables in the corporate governance system. It is found that there is a significant and strong relationship among three dimensions. Corporate governance is a construct of our study and principles, processes and business results are dimensions that explain this construct. The seventh hypothesis is formed to test whether corporate governance is constituted from these three dimensions or not. Cronbach alpha of these three dimensions (principles, processes and business results) is 91%. In other words, it is found that these three dimensions explain the construct (corporate governance system) of our study. Stakeholder governance model is used to test the hypotheses of the study. In sum, this study showed us that stakeholder governance model works in electric utilities industry and that there is an integrity among the variables and elements of corporate governance system.

Keywords: stockholder governance, stakeholder governance, corporate governance, sustainability, corporate social responsibility

1. Introduction

Today, corporate governance is very important for the sustainable development of companies and countries. Corporate governance has gained attention of the public by unethical behaviors in large companies and their sudden failures. A good corporate governance is based on the interests of all the stakeholders. Interest of all stakeholders can be included only by making a solid social contracts with the stakeholders. This solid social contracts should be based on ethical codes and behaviors. There must be integrity among ethical codes and behaviors. Legal contracts, which refers to the past, is not enough to ensure that interests of all stakeholders protected properly, especially in very large corporations. Therefore, legal contracts with the stakeholders must be complemented with social contracts based on ethical codes. A social contract based on ethical codes and behaviors is expected to create competitive advantage for companies, which also guarantee their sustainability in the long-run. Variables that are directly or indirectly related with ethics must be used in a corporate governance system. These variables are grouped under the dimensions of principles, processes and business results. The purpose of this study is to show that relationships among these three dimensions exist. This will prove us that corporate governance is a system and it can be used to develop sustainability and competitive advantage. In the second section of the study we will start with the literature review. In the third section, we compared the various theories of corporate governance and its practice in different countries and industries. In the fourth section, we will first define principles, processes and business results and then show the relationships among these three components. In the fifth section, we will explain our research methodology and introduce our seven hypotheses regarding corporate governance system. We will introduce the empirical findings of our study in the sixth section. Finally, conclusion will be presented in the seventh section.

2. Literature Review

Different scholars made different definitions for corporate governance. Corporate governance is a system and this system is used to direct and control companies to produce high financial performance (MacMillan & Downing, 1999). Corporate governance is a structure where corporate governance mechanisms such as monitoring, bonding, board of directors and executive initiatives are used to control managers at the organizational apex (Donaldson, 1990). Institutional arrangements for the relationships among these economic actors (Letza, Sun, & Krikbride, 2004) are another definition of corporate governance. Corporate governance is a system based on three components, which are principles, processes and business results (Gunay, 2008). In order to establish this system, benefits of all the stakeholders should be considered. Interest of all stakeholders is first posited by Freeman (1984). Before Freeman corporate governance was refering to the interests of shareholders (Demsetz, 1983; Fama, 1980; Fama & Jensen, 1983; Jensen & Meckling, 1976; Shleifer & Vishny, 1997). Today, it is very well known that interest of all stakeholders is a must for existence and sustainability of companies (Ertuna, 2005; Greenwood, 2001; Mills & Weinstein, 2000; O'Higgins, 2001; Post, Preston & Sachs, 2002). In sum, there are shareholder governance and stakeholder governance (Bhasa, 2004; Friedman & Miles, 2002; Gamble & Kelly, 2001; Prabhaker, 1998; Sternberg, 1997; Turnbull, 1997; Vinten, 2001) in companies. A firm cannot exist without satisfying the interests of its stakeholders (e.g., employees, suppliers, customers, shareholders). Corporate governance is a system that refers to interests of all stakeholders rather than only shareholders (Hollensbe, Wookey, Hickey, George, & Nichols, 2014). Concepts such as triple bottom line became important in the governance of corporations (Elkington, 1998; Jayachandran, Kalaignanam, & Eilert, 2013; McDonnell & King, 2013). Corporations have ethical, environmental and social responsibilities for their stakeholders (Enquist, Johnson, & Skalén, 2006). Therefore, a good corporate governance is a system which can balance the interests of its stakeholders by performing its ethical, environmental and social responsibilities and achieve sustainability for the corporation in the long-term. This definition, indeed, points to the stakeholder governance in the twenty-first century. There is a very complex network of relationships among the stakeholders of the corporations. This makes stakeholder governance a more rational model when compared with stockholder governance model in today's complex business environment (Yumuk Gunay & Apak, 2014).

3. Comparison of Corporate Governance Theories and Practices in Different Countries and Industries

3.1 Comparison of Corporate Governance Theories

There are various theories related with corporate governance. Theories such as agency theory, resource dependence theory, traditional stewardship theory, and transaction cost economics theory refer to the stockholder governance model. Theories such as modern stewardship theory, integrative social contact theory, corporate social performance theory, resource-based theory, corporate social responsibility theory, normative stakeholder theory refer to the stakeholder governance model. Theories related with stockholder governance refer to the companies in the Anglo-Saxon world and theories related with stakeholder governance model refer to the companies in the Continental Europe-Japanese world (Gunay, 2008). But these theories began to converge at the end of 20th century. Theories such as stakeholder-agency theory (Hill & Jones, 1992) and instrumental stakeholder theory (Jones, 1995) refers to this convergence. Globalization and network relationships via internet among the stakeholders of the firm are the main reasons of this convergence. Today, companies in all around the world try to balance the interests of their stakeholders in order to achieve sustainability in the long-term. Our study uses theories related with the stakeholder governance model.

3.2 Comparison of Corporate Governance Practices in Different Countries

There are different studies that compare the corporate governance practices in different countries. For example, Schneider and Chan (2001) compared the corporate governance models in Germany, United States of America, Switzerland and France and found that there is convergence among the corporate governance systems in these four countries as a result of globalization. Board attributes are examined in this study. Another study that examined the board attributes in US, UK and Netherlands also found convergence among the corporate governance systems. Stakeholder and stockholder governance models are also compared in this study (Maassen, 1999). A report published by Asian Productivity Organization (2007) compared corporate governance practices in Republic of China, India, Japan, Malaysia, Philipines, Singapore and Vietnam. Comparison and convergence of stockholder and stakeholder governance models can also be seen in these seven countires. Another report published by International Finance Corporation (2015) shows that stakeholder interests are embedded in the corporate governance system of European Union. Another comparison is made among 28 OECD countries. The roles of creditors and employees in influencing the corporate governance systems of OECD countries are especially important (OECD, 2004).

3.3 Comparison of Corporate Governance Practices in Different Industries

There are different studies about corporate governance practices in different industries. A report published by IRRC (2006) compared 100 leading global companies in ten industries (chemicals, electric utilities, motor vehicles, industrial equipment, metals & mining, forest products, petroleum, coal, food production and airlines). Companies are scored based on board oversight, management execution, public disclosure, strategic planning and emissions accounting practices about the natural environment and ethics in this report. Case studies are conducted for the 13 companies in different industries in Latin America. Eight of these companies have practices related with stakeholder governance model and the rest of them have stockholder governance practices (IFC, 2006). There are other studies that are conducted in only one sector in countries regarding the corporate governance practices. For example, corporate governance practices of 12 companies are examined in auto industry in India based on 10 subcomponents about corporate governance (Sharma, 2013). Another example is the report published about corporate governance practices in electricity sector in four Asian countries (Thailand, India, Philippines, Indonesia). Electricity sector in general but not companies are examined in this study (EGI, 2006). These are some of the examples of corporate governance practices in different industries. Our study examined the 74 world's biggest companies in electric utilities industry in different countries from the perspective of stakeholder governance model. The purpose of our study is to prove that corporate governance is a system and that there is integrity among the variables and elements of this system based on stakeholder governance model. The details of this model are given in the sections four and five.

4. Definitions of Principles, Processes and Business Results and Relationships among These Three Components in the Corporate Goverance System

There are three components that shape the corporate governance system. The first component is principles. Principles are related with the values, shared beliefs, customs, identity, vision and ethos of companies (Arthur, 1987; Jensen & Meckling, 1994). Principles are related with values that motivate people to act (Wood, 1991). The second component is processes and it refers to relationships between firm and its stakeholders (Frooman, 1999; Scholes & Clutterbuck, 1998). Finally, the third component is the business results. It is related with the outcomes. This third component is the result of principles and processes in the corporate governance system (Scholes & Clutterbuck, 1998). All of these three components affect one and another. In other words, there is a bilateral and/or multilateral relationship among these three components (Akerlof, 1983; Clarke, 1998; Freeman, 1999; Kennedy, 1998). Wrong principles such as short-term profit maximization may lead to processes such as opportunistic behaviors. These kinds of wrong principles and unethical behaviors may lead to undesired business results such as bankruptcy (MacMillan & Downing, 1999). On the other hand, if company strategies and values based on ethical codes or principles such as mutual-trust, trust based behaviors between the firm and its stakeholders can be formed as the processes. Competitive advantage can be one of the business results of these kinds of principles and processes (Plender, 1998). As can be seen in these two examples, a corporate governance system can be based on right or wrong principles and processes. Desired and undesired business results would be the outcome in the corporate governance system. It is not only principles and processes that affect business results but also business results are expected to affect principles and processes. Finally, all of the variables under each of three components also affects one another. In sum, there is a holistic approach (Bohm, 1980) in the corporate governance system. In other words, there must be an integrity among all the elements of three dimensions of components in the corporate governance system. The relationship among these three components is depicted in Figure 1 (Gunay, 2008).

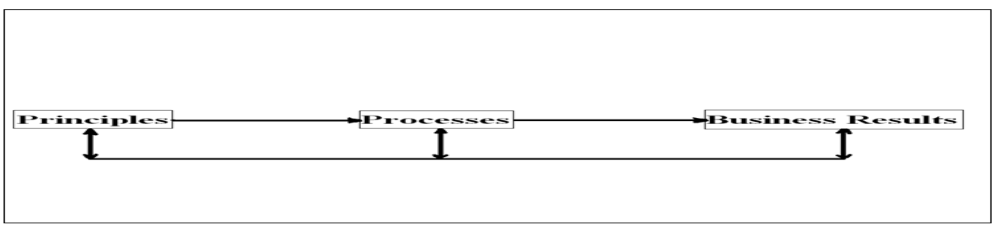

Figure 1. The framework for the stockholder and stakeholder governance models

Gunay, S. G. (2008), Corporate Governance Theory: Comparison of Stockholder and Stakeholder Governance Models, Iuniverse, USA.

The variables that are related with principles, processes and business results can be seen in Figure 2 below. As can be seen in the Figure 2, there are twelve variables under the dimension of principles, nine variables under the dimension of processes and thirteen variables under the dimension of business results.

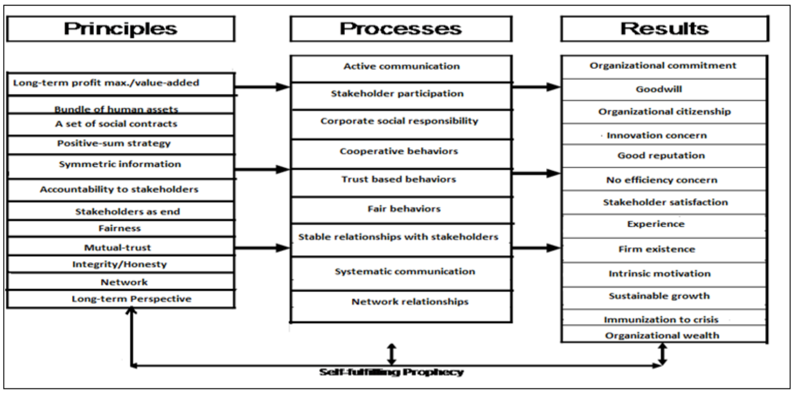

Figure 2. Corporate Governance System Dimensions and Related Variables

Gunay, S. G. (2008), Corporate Governance Theory: Comparison of

Stockholder and Stakeholder Governance Models, Iuniverse, USA.

5. Research Methodology and Hypotheses

The purpose of this study is to test the relationships among three dimensions: principles, processes and business results. There are twelve variables under dimension of principles, nine variables under the dimension of processes and thirteen variables under the dimension of business results. Twelve variables under the principles dimension are operationalized with 46 elements, nine variables under the processes dimension are operationalized with 58 elements and thirteen variables under the business results dimension are operationalized with 49 elements. All of these 34 variables and 153 elements are given in the appendix of this paper. Seven hypotheses are formed to test these relationships among these three dimensions. 74 companies in electric utilities industry are used to test the hypotheses. These companies are listed in Forbes Global 2000. Electric utilities industry is chosen for two reasons. First of all, companies in this industry are largest ones in the world and they are expected to produce satisfactory corporate social responsibility and sustainability reports. Second, sample size in this industry is adequate to test the hypotheses. Corporate governance, sustainability and corporate social responsibility reports of these 74 companies are coded with 34 variables and 153 elements in the corporate governance system and regression model is used to test the hypotheses. If any of the elements under one variable is found in the reports of the companies, it is coded as 1, else as 0. Three indices are formed for principles, processes and business results. All of these variables and elements under three dimensions are based on stakeholder governance model in our study. For example, Persons (2015) used 10 characteristics, which are based on stockholder governance, in a sample of 50 world's most admired companies. The corporate governance model developed by Gunay (2008) is based on stakeholder governance and this model is used to test seven hypotheses in the study. Seven hypotheses are are given below.

H_1: Principles affect processes significantly in the corporate governance system.

H_2: Processes affect business results significantly in the corporate governance system.

H_3: Business results affect principles significantly in the corporate governance system.

H_4: Principles and processes affect business results significantly in the corporate governance system.

H_5: Principles and business results affect processes significantly in the corporate governance system.

H_6: Processes and business results affect principles significantly in the corporate governance system.

H_7: Principles, processes and business results explain the construct of corporate governance system.

The seven null hypotheses that are given above will show us whether corporate governance based on principles, processes and business results is a system or not. If seven null hypotheses are not rejected, we will know that 34 variables under three dimensions are significantly determinant in the corporate governance system. The results about coefficients of determination in the regression analysis will also tell us the magnitude of the relationships among these three dimensions.

6. Empirical Results of the Study

The results of the six regression models are summarized in Table 1. As can be seen in table 1, principles, processes and business results affect one another significantly. Coefficients of determination results are also high in these six regression models. Coefficient of determination results are between 57.3% and 74%. Principles dimension explains 68.4% of processes dimension. Processes dimension explains 61.5% of business results dimension. Business results dimension explains 57.3% of principles dimension. Principles and processes dimensions explain 65.2% of business results dimension. Principles and business results dimensions explain 74.3% of processes dimension. Processes and business results dimensions explain 71.5% of principles dimension. Based on these findings, none of the first six null hypotheses are rejected. Cronbach alpha of principles, processes and business results is 91%. These three dimensions explain the construct of corporate governance system and the realibility of the study is high. Thus, the seventh null hypothesis could not be rejected also.

Table 1. Regression model results of the study

Dependent Variable	Principles	Processes	Results	Principles	Processes	Results
Independent Variables	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Principles		1,028***				
Processes			0,859***			
Business Results	0,556***					
Principles					0,680***	0,466***
Processes				0,489***		0,549***
Business Results				0,206***	0,338***	
R^2	0,573	0,684	0,615	0,715	0,743	0,652
F Value	96,448	156,121	114,926	88,916	102,565	66,449

*, **, *** Statistically significant at $p< 0.10$, $p< 0.05$, and $p< 0.01$, respectively.

7. Conclusion

The main purpose of this study is to test whether corporate governance is a system or not. The other objective of our study is to show that there is integrity among the variable and elements of corporate governance system based on stakeholder governance model. In order to achieve these goals, 74 firms in the electric utilities industry is used. Corporate governance model developed by Gunay (2008) is used to test whether corporate governance is a system or not. In this model, principles, processes and business results are the dimenisons of the corporate governance system. These three dimensions are explained by 34 variables and 153 elements. The corporate social responsibility, sustainability and corporate governance reports of these 74 companies are all coded with 34 variables and 153 elements. Indices are formed for each dimension. Six hypotheses are formed to test the relationships among these three dimensions via regression models. Seventh hypothesis is also formed to test whether these three dimensions explain the construct of corporate governance system. Regression results show us that there is a strong and significant relationship among these three dimensions. Cronbach alpha shows us that these three dimensions explain 91% of the construct of corporate governance system. These results show us that corporate governance is a system and it is constituted from principles, processes and business results. Stakeholder governance model is used to test the hypotheses of the study. In sum, this study showed us that stakeholder governance model works in electric utilities industry. Since it is proved that corporate governance is a system, this system can be used to relate the financial, social and environmental performances of the companies with their index scores in electric utilities industry and in other industries. Further future studies in other industries are expected to increase the external validity of the corporate governance model.

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Appendix A. Variables/Elements Related with Principles

V1.	**Long-term Profit Maximization/Value-Added**	**V7**	**Stakeholders as an End**
E1	long-term profitability or firm value	E1	csr
E2	value added (added value)	**V8.**	**Fairness**
V2.	**Bundle of Human Assets**	E1	Fair
E1	human	E2	equal distribution
E2	human values	E3	distributive justice
E3	human resources	E4	equality
E4	social entity	**V9.**	**Mutual-Trust**
V3.	**A Set of Social Contracts**	E1	trust
E1	social contracts	E2	credibility
E2	psychological contracts	E3	benevolence
V4.	**Positive-Sum Strategy**	E4	reliability
E1	positive-sum	E5	confidence
E2	synergy	**V10.**	**Integrity/Honesty**
V5.	**Symmetric Information**	E1	integrity
E1	transparency	E2	honesty
E2	transparent	E3	consistency
E3	openness	E4	correctness
V6.	**Accountability to Stakeholders**	E5	coherence
E1	accountability to Stakeholders	**V11.**	**Network**
E2	AA1000	E1	networking
E3	Global Reporting Initiative	E2	interactions
E4	SA8000	E3	interconnectedness
E5	OHSAS 18001	E4	communication
E6	ISO 14001	E5	intranet
E7	Global Compact	E6	interactive
E8	ISO 26000	**V12.**	**Long-term Perspective**
E9	ISAE	E1	long run
		E2	long-term perspective

Appendix B. Variables/Elements Related with Processes

V13.	**Active Communication**	**V17.**	**Trust-Based Behaviors**
E1	reciprocal communication	E1	Trust
E2	active communication	E2	Confidence
E3	social audits	**V18.**	**Fair Behaviors**
E4	open communication	E1	Fair
E5	corporate social reports	E2	Favoring
E6	focus groups	E3	Sharing the wealth (stock option plans)
E7	surveys	**V19.**	**Stable Relationships with Stakeholders**
E8	workshops	E1	ongoing relationship
E9	meetings	E2	strong relationships
E10	panels	E3	invest in relations
E11	hotlines	E4	internal growth
E12	public relations	E5	long-lasting relationships
E13	dialogue	E6	stable relationships
E14	listen	E7	on-going relationships
E15	learn	E8	close relationships
V14.	**Stakeholder Participation**	E9	employee training
E1	participation	E10	long-term contracts
E2	engage	E11	Education
E3	representation	**V20.**	**Systematic communication**
E4	involvement	E1	systematic communication
V15.	**Corporate Social Responsibility**	E2	Periodic
E1	corporate social responsibility	E3	Every
E2	health	E4	Regular
E3	safety	**V21.**	**Network Relationships**
E4	natural environment	E1	Network
E5	natural capital	E2	letting employees share their knowledge and ideas
E6	social capital	E3	letting employees form close & ongoing interactions
E7	triple bottom line	E4	allowing employees challenge rules and norms
V16.	**Cooperative Behaviors**	E5	allowing employees invent new ways of working
E1	cooperation	E6	decentralization
E2	co-determination	E7	empowerment
E3	collaboration		
E4	collective action		
E5	unity		
E6	together		

Appendix C. Variables/Elements Related with Business Results

V22.	**Organizational Commitment**
E1	commitment
E2	loyalty
V23.	**goodwill**
E1	ethics
V24.	**Organizational Citizenship**
E1	citizenship
E2	Allegiance to a company
E3	citizen
V25.	**Innovation Concern**
E1	innovation
E2	finding new ways to innovate
E3	devoting resources to employees' ideas
E4	continuous improvement
E5	product quality
V26.	**Good Reputation**
E1	reputation
E2	broad public acceptance
E3	award
V27.	**No Efficiency Concern**
E1	no efficiency concern
V28.	**Stakeholder Satisfaction**
E1	high morale among employees
E2	stakeholder satisfaction
E3	sound environmental standards
E4	forming ethics codes
E5	ethic committees
E6	ethics auditing
E7	council
V29.	**Experience**
E1	experience
E2	human capital
E3	firm-specific skills
E4	tacit resources held by the employees
E5	individual learning and development
E6	generation of explicit and implicit knowledge
V30.	**Firm Existence**
E1	existence
E2	Survival and success of an organization
E3	staying in business
E4	survive
E5	longevity
E6	continuity
E7	strength
V31.	**Intrinsic Motivation**
E1	intrinsic motivation
E2	motivate
E3	award to employees
E4	dedicated
V32.	**Sustainable Growth**
E1	sustainable growth
E2	sustained performance
E3	sustainable or sustainability
V33.	**Immunization to Crisis**
E1	immunization to crisis
E2	when a firm is resilient to short-term shocks
E3	competitive advantage
V34.	**Organizational Wealth**
E1	organizational wealth
E2	Increasing the value of an organization as a whole
E3	accepting the goal of long term wealth maximization
E4	value chain