

Impact of Corporate Governance on Organizational Performance

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Abstract- This study examined whether corporate governance has impact on organizational performance in Financial Institutions as research problem. This research was carried out with objective to measure association between Corporate Governance and Financial Institution's Performance in Batticaloa district. Conceptual framework has been developed to measure linkages between Corporate Governance and Financial Institution's Performance. Board Size, Corporate Governance Mechanism, Communication Strategies, and Code of Conduct are considered as the measurement variables of Corporate Governance which was derived from Changezi & Saeed (2013) and Customer Satisfaction, Employee Commitment and Corporate Reputation are considered as the measurement variable of Organizational Performance which was derived from Bayoud (2012) and Carton (2004). Questionnaires were used to collect data for this study. 115 Management Respondents and 115 Customers from whole Financial Institutions in Batticaloa district have been selected for this study. Data were analyzed and evaluated by Univariate and Bivariate techniques. In Univariate analysis, Descriptive statistic has been used for the analysis. In Bivariate analysis, Correlation and multiple regressions have been used for the analysis. Findings have shown the Corporate Governance and Organizational Performance are at high level. Moreover, it also found that there is a strong positive relationship between Corporate Governance and Organizational Performance. Corporate Governance significantly impacts Organizational Performance of Financial Institutions. These findings would be useful to consider more on Corporate Governance practices to avoid the Corporate Collapses and to achieve successful Organizational Performance

Keywords- Corporate Governance, Organizational Performance.

INTRODUCTION

Corporate governance has admired as an emerging aspect in past decades to improve the performance of companies (Mishra et al., 2001; McConaughy et al., 1998; Khatri et al., 2001; Kwak, 2003; Black et al., 2003). Because best practice of corporate governance diminishes threat for stakeholders, attract investment capital and enhances the performance of companies (Spanos, 2005). Good corporate governance increases the profitability of companies and long term value of firms (Khumani et al., 1998). Hence it has become an important concept for every company. Moreover, failures of companies were taken place in the mind of researchers to study about corporate governance practices.

Cadbury (1992) defined corporate governance as "the system by which companies are directed and controlled. Corporate governance is mainly considered with board of directors' duties and responsibilities and relationship with the stakeholders to meet the success of company. The Organization for Economic Co-operation Development Principles of Corporate Governance (1999) states that "Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. It also provides the structure through which the objectives of the company are set, and the means of attaining those

objectives and monitoring performance are determined”. Thus definition of corporate governance can be concluded that mechanisms developed into the company by which companies are directed to increase long term value of stakeholders and ultimately improving the performance of companies.

There are varieties of definition of organizational performance in the literature. In general, Carton (2004) states that “the concept of organizational performance is based upon the idea that an organization is the voluntary association of productive assets, including human, physical, and capital resources for the purpose of achieving a shared purpose”.

The collapse of companies has highlighted to study about corporate governance practices and its impact on organizational performance. Therefore, the purpose of study was to examine impact of corporate governance on organizational performance in financial institutions in Batticaloa district. Reason for selecting financial institutions is that there are many expansions of financial institutions and also it is one of growing sector in Batticaloa. It is important to study corporate governance system and its relationship with organizational performance in Batticaloa. Rare research has been conducted regarding this topic so this study is important and relevant in order to fill the knowledge gap to find out to what extent corporate governance impacts on organizational performance.

LITERATURE REVIEW

Corporate Governance is broad concept and it is not easy to describe due to continuously expanding the boundaries of the concept. The definition may vary based on the different perspective of researchers. In literature, the basic definition of Corporate Governance can be defined as “the system by which companies are directed and controlled” (Cadbury, 1992). OECD (1999) states “this structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as the board, managers, shareholders and other stakeholders, and spells out the rules and procedures for making decisions on corporate affairs”. However some of definitions of Corporate Governance are generally classified into value creation and value protection which is accomplished through corporate governance (Heenetigala, 2011). According to Heenetigala (2011), Value creation indicates that developing the long term goals for sustainable performance by focusing on the shareholders of the company. Value protection based on accountability of managers and protects the interest of both shareholders and stakeholders (Rezaee, 2009). Stone & Andrew et al. (1998) state that “making such set of laws and motivation through which administration of company is bounded and administered for profit maximization which ultimately adds the value for shareholders as well as for management”. Hermalin (2005) and Lee (2008) indicate that “the concept of corporate governance lies in between all these aspects and management of organizational resources fairly while concerning the interests of all stakeholders”.

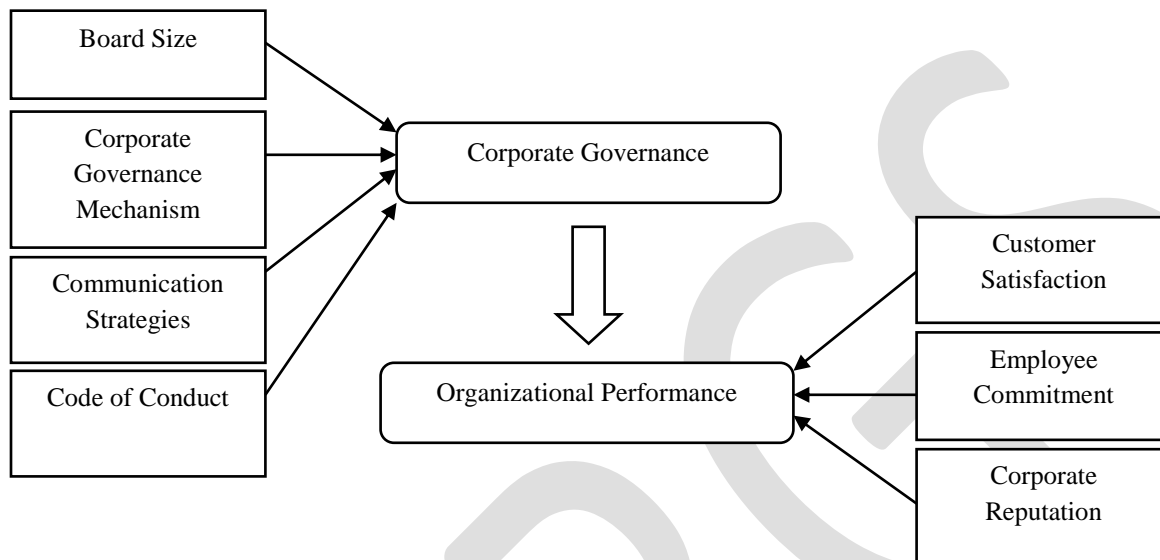
Concept of organizational performance is an important aspect which has been using in all areas of business researches and it is difficult to have general definition and measurement by reason of continuously expanding their boundaries. Akal (1992) defines that “organizational performance is the evaluation of all the efforts devoted to achieving the business goals”. Most of the researchers argue that definition of organizational performance is incorporated with efficiency and effectiveness. Santos & Brito (2012) state “business performance or firm performance is a subset of organizational effectiveness that covers operational and financial outcomes”. Conversely, Cameron & Whetten (1983) indicate that “organizational effectiveness is a broader construct that captures organizational performance, but with grounding in organizational theory that entertains alternate performance goals”.

Relationship between corporate governance and organizational performance is still a fundamental issue for the researchers. Some scholars have identified as positive relationship and some scholars have failed to show a positive association. For this reason, this study is vital to find what kind of association that financial institutions have.

CONCEPTUAL FRAMEWORK

Based on literature survey following conceptual framework was developed. This conceptual framework establishes link between corporate governance and organizational performance.

Figure 1 Conceptual Model



(Sources: Changezi & Saeed, 2013; Bayoud, 2012; Carton, 2004)

METHODOLOGY

This section provides how this study has been conducted to examine the impact of Corporate Governance on Organizational Performance in Batticaloa district. This chapter describes the method of data collection, the variables used to test the hypothesis, and statistical techniques used to define the results.

RESEARCH DESIGN

Research design deals to plan and provide the path to do the study to obtain the validity of the findings (Mouton, 1996). According to the research design, the structured questionnaires were firstly issued to respondents from management by visiting their financial institutions. After that, the customers of those financial institutions were approached and questionnaires were issued to them. And also, other structured questionnaires were issued to customers through the social networks. Both questionnaires' data were entered in databases and databases were consolidated into one database for analysis purpose. Descriptive analysis, correlation, regression, and ANOVA analysis were employed to test the hypotheses. After analyses were performed, findings were discussed. As result of the findings, conclusions were drawn.

STUDY POPULATION

Central Bank of Sri Lanka (2014) comprised the financial institutions as Licensed Commercial Banks (LCBs) & Licensed Specialized Banks (LSBs), Finance & Leasing Companies, and Insurance Companies. As at 2014, there were 25 Licensed Commercial Banks (LCBs) & 9 Licensed Specialized Banks (LSBs), 56 Finance & Leasing Companies, and 21 Insurance Companies (Central Bank of Sri Lanka, 2014).

SAMPLE SIZE

There were 12 Licensed Commercial Banks (LCBs) & 8 Licensed Specialized Banks (LSBs), 24 Finance & Leasing Companies, and 15 Insurance Companies in Batticaloa district (Manmunai North Divisional Secretariat). This research covers all the main branch of financial institutions in Batticaloa district (Manmunai North Divisional Secretariat). Thus, 59 financial institutions were considered as the population.

SAMPLING METHOD

Total numbers of financial institution were 59 in Batticaloa district (Manmunai North Division Secretariat). There were 115 management respondents. Simple random sampling method was applied to select the samples of management respondents to measure the Corporate Governance of financial institution. Quota sampling method was applied to select the customers of the selected financial institutions to measure the Organizational Performance.

DATA COLLECTION

This study was carried out based on primary data. The data were collected from Management respondents and Customers of financial institutions. For that reasons, two structured questionnaires were issued to collect the data. Questionnaire I was used to measure Corporate Governance from Management respondents of financial institutions and questionnaire II was used to measure Organizational Performance from Customers of financial institutions.

Primary data were collected through closed ended statements in both questionnaires. Likert scale of 1-5 which ranges from “strongly disagree” to “strongly agree” were employed to identify the responses from management respondents and customers.

METHOD OF DATA ANALYSIS AND EVALUATION

UNIVARIATE ANALYSIS

This study evaluates individual characteristics of Dimensions and variables. Mean values and standard deviation are considered to assess the level of dimensions and variables with the following criteria.

Board size is a numerical scale dimension and it is converted to 5 point likert scale. Therefore, it needs specific decision criteria to evaluate the level of board size. For that reason, level of the board Size (X_1) is explained by the ideal number of board of directors stated in the earlier researches. Lipton & Lorsch (1992) recommend limiting the membership of board to ten people, with a preferred size of eight or nine. Adams & Mehran (2011) stated that ideal size of board is 10-12 members. Jensen (1993) stated that seven or eight directors are ideal for the board. With the support of the studies, a decision criterion is developed for this study.

Table 1: Decision Criteria for level of board size

Range for Decision Criteria	Decision Criteria	Decision Attribute
More than 12 board of directors	$X_1 > 3$	Larger board size
7-9 board of directors	$X_1 = 3$	Optimum board size
1-3 board of directors	$X_1 < 3$	Smaller board size

Where X_1 = mean value of board size

Rest of the dimensions such as corporate governance mechanism, communication strategies, code of conduct, customer satisfaction, employee commitment, and corporate reputation are assessed through the below decision criteria.

Table 2: Decision Criteria for Univariate Analysis

Decision Criteria	Decision Attribute
$1.0 \leq X_i \leq 2.5$	Low Level
$2.5 < X_i \leq 3.5$	Moderate Level
$3.5 < X_i \leq 5.0$	High Level

Where X_i = mean values of an dimension/indicator/variable

Independent Variable & Dimensions

Dependent Variable & Dimensions

X_2 = Mean Value of Corporate Governance Mechanism

X_5 = Mean Value of Customer Satisfaction

X_3 = Mean Value of Communication Strategies

X_6 = Mean Value of Employee Commitment

X_4 = Mean Value of Code of Conduct

X_7 = Mean Value of Corporate Reputation

Where X_i = (2,3,4,5,6,7)

Bivariate Analysis

To identify the relationship between the corporate governance and organizational performance, the correlation analysis was employed.

FINDINGS

Corporate Governance and its Dimensions

Table 3: Overall Measures of Corporate Governance and its Dimensions

Description	Dimensions				Independent variable
	BS (X_1)	CGM (X_2)	CS (X_3)	CC (X_4)	Corporate Governance
Mean	2.904	4.357	4.327	4.237	3.956
Standard Deviation	0.878	0.471	0.553	0.589	0.336
Coefficient of variance	0.302	0.108	0.128	0.139	0.085
Maximum	5.00	5.00	5.00	5.00	4.75
Minimum	1.00	2.67	2.20	2.00	3.05
Number of data	115	115	115	115	115

Where BS = Board Size, CGM = Corporate Governance Mechanism, CS = Communication Strategies, and CC = Code of Conduct

This independent variable as corporate governance includes four dimensions which are board size, corporate governance mechanism, communication strategies, and code of conduct. Board Size dimension has the mean values of 2.904. It shows almost 3 therefore it can be concluded that majority of Financial Institutions have 7-9 board of directors and it is the optimum or ideal size of board. Other dimensions show high level of significant in the Corporate Governance. They have the mean values of 4.357, 4.327, and 4.237

respectively. In addition, most of the respondents have expressed the common opinion toward the dimensions of Corporate Governance (Standard Deviations are 0.878, 0.471, 0.553, and 0.589 respectively).

Among 115 Management respondents, Corporate Governance Mechanism was most significant (Mean = 4.357) to Corporate Governance rather than other dimensions. Next, Communication Strategies was most significant (Mean = 4.327) to Corporate Governance rather than Code of Conduct dimensions.

Corporate Governance's Dimensions in respect of Financial Institutions

Table 4: Overall Measures of Corporate Governance Dimensions in respect of Financial Institutions

Measure	Commercial Bank & Specialized Bank				Finance & Leasing Company				Insurance Company			
	BS	CGM	CS	CC	BS	CGM	CS	CC	BS	CGM	CS	CC
Mean	2.53	4.28	4.24	4.05	3.23	4.43	4.35	4.28	3.00	4.38	4.44	4.47
SD	0.81	0.51	0.55	0.52	0.95	0.48	0.60	0.69	0.62	0.39	0.48	0.42
CV	0.32	0.12	0.13	0.13	0.29	0.11	0.14	0.16	0.21	0.09	0.11	0.09
Minimum	1.00	2.67	2.40	2.75	1.00	2.83	2.20	2.00	2.00	3.67	2.6	3.5
Maximum	4.00	4.83	5.00	4.75	5.00	5.00	5.00	5.00	4.00	5.00	5.00	5.00
N	45	45	45	45	43	43	43	43	27	27	27	27

Where BS = Board Size, CGM = Corporate Governance Mechanism, CS = Communication Strategies, CC = Code of Conduct, SD = Standard Deviation, CV = Coefficient of Variable, N = Number of observation

According to the table 4, mean value for Board Size is at highest level in Financial & Leasing Companies (Mean = 3.23) rather than other companies to support to Corporate Governance. However, mean values of Financial Institution is almost 3. Therefore, it can be concluded that 7-9 board of directors are enough to do board functions. Mean value of Corporate Governance Mechanism is at highest level in Finance & Leasing Companies rather than other companies (Mean = 4.43). It shows that these companies have more concentrated on recording minutes, shares owned by board, meeting information, performance monitoring, reasonable for development of objectives, and have clear policy for concurrent positions. Mean value of Communication Strategies is at highest level in Insurance Companies rather than other companies (Mean = 4.44). It shows that these Insurance Companies have more concentrated on public access of financial reports, access to critical information, accessible through internet, arrangement of general meetings, and assessing mechanism. Mean value of Code of Conduct is at highest level in Insurance Companies rather than other companies (Mean = 4.47). It shows that these Insurance Companies have more concentrated on tracking changes in ownership, rights and responsibilities of shareholders, award and bonuses, and consideration of all stakeholders.

Corporate Governance in respect of Financial Institutions

Table 5: Overall Measures of Corporate Governance in respect of Financial Institutions

Measure	Commercial Bank & Specialized Bank	Finance & Leasing Company	Insurance Company
Mean	4.020	3.945	4.072

Standard Deviation	0.435	0.542	0.279
Coefficient of Variation	0.108	0.137	0.069
Minimum	2.57	2.30	3.34
Maximum	4.75	4.90	4.49
Number of Observation	45	43	27

According to table 5, Mean value of Corporate Governance is highest in Insurance Companies (Mean = 4.072) rather than Commercial Banks, Specialized Banks and Finance & Leasing Companies. It can be derived that Insurance Companies have highly Corporate Governing Financial Institution in Batticaloa.

Corporate Governance and its Dimensions

Table 6: Overall Measures of Organizational Performance and its Dimensions

Description	Dimensions			Dependent Variable
	CSA (X ₅)	EC (X ₆)	CR (X ₇)	Organizational Performance
Mean	4.397	4.316	4.241	4.3178
Standard Deviation	0.476	0.453	0.486	0.408
Coefficient of Variance	0.108	0.105	0.115	0.095
Maximum	5.00	4.83	5.00	4.88
Minimum	2.40	2.33	2.67	2.64
Number of data	115	115	115	115

In this table, CSA = Customer Satisfaction, EC = Employee Commitment, CR = Corporate Reputation

This dependent variable as organizational performance includes three dimensions which are customer satisfaction, employee commitment, and corporate reputation. These dimensions show high level in the Organizational Performance. They have the mean values of 4.397, 4.316 and 4.241 respectively. In addition, most of the respondents have expressed the common opinion toward the dimensions of Corporate Governance (Standard Deviations are 0.476, 0.453 and 0.486 respectively).

Among 115 Customer respondents, Customer Satisfaction was most significant (Mean = 4.397) to Organizational Performance rather than other dimensions. Next, Employee Commitment was most significant (Mean = 4.316) to Organizational Performance rather than Corporate Reputation dimension.

Organizational Performance's Dimensions in respect of Financial Institutions

Table 7: Overall Measures of Organizational Performance Dimensions in respect of Financial Institutions

Measure	Commercial Bank & Specialized Bank			Finance & Leasing Company			Insurance Company		
	CSA	EC	CR	CSA	EC	CR	CSA	EC	CR
Mean	4.31	4.22	4.13	4.50	4.47	4.35	4.39	4.22	4.26
SD	0.52	0.55	0.52	0.39	0.28	0.47	0.52	0.45	0.42

CV	0.12	0.13	0.13	0.09	0.06	0.11	0.12	0.11	0.10
Minimum	2.60	2.33	2.67	2.80	3.50	3.00	2.40	3.00	3.33
Maximum	4.80	4.83	4.83	5.00	4.83	5.00	5.00	4.67	5.00
N	45	45	45	43	43	43	27	27	27

Where CSA = Customer Satisfaction, EC = Employee Commitment, CR = Corporate Reputation, SD = Standard Deviation, CV = Coefficient of Variable, N = Number of observation

According to table 7, Mean value of Customer Satisfaction is highest level in Finance & Leasing Companies rather than other companies (Mean = 4.50). It shows that these companies are more concentrated on customer commitment, customer loyalty. Mean value of Employee Commitment is highest level in Finance & Leasing Companies rather than other companies (Mean = 4.47). It shows that that these companies are more concentrated on affective commitment, continuance commitment, and normative commitment. Mean value of Corporate Reputation is highest level in Finance & Leasing Companies rather than other companies (Mean = 4.35). It shows that that these companies are more concentrated on financial aspects, social aspects, and environmental aspects.

Organizational Performance in respect of Financial Institutions

Table 8: Overall Measures of Organizational Performance in respect of Financial Institutions

Measure	Commercial Bank & Specialized Bank	Finance & Leasing Company	Insurance Company
Mean	4.218	4.440	4.289
Standard Deviation	0.460	0.315	0.411
Coefficient of Variation	0.109	0.071	0.096
Minimum	2.64	3.10	2.91
Maximum	4.71	4.88	4.82
Number of Observation	45	43	27

According to table 8, Mean value of Organizational Performance is highest in Finance & Leasing Companies (Mean = 4.44) rather than Commercial Banks, Specialized Banks and Insurance Companies. It can be derived that Finance & Leasing Companies have highly performing Financial Institution in Batticaloa.

Relationship between corporate governance and organizational performance

Table 9: Correlation Analysis: Pearson Correlation

	BS	CGM	CS	CC	CSA	EC	CR	CG	OP
BS	1.000								
CGM	-0.122	1.000							
CS	-0.343**	0.452**	1.000						

CC	-0.316**	0.416**	0.702**	1.000					
CSA	-0.055**	0.570**	0.479**	0.282**	1.000				
EC	-0.173**	0.434**	0.616**	0.329**	0.649**	1.000			
CR	-0.216**	0.361**	0.471**	0.535**	0.575**	0.646**	1.000		
CG	-0.708**	0.598**	0.793**	0.787**	0.412**	0.464**	0.498**	1.000	
OP	-0.171	0.526**	0.601**	0.444**	0.857**	0.879**	0.860**	0.530**	1.000

** Correlation is significant at the 0.01 level (2-tailed)

Results show that there is weak negative relationship between Board Size and Organizational Performance ($r = -0.171$, $p > 0.01$) but it is not significant, strong positive relationship between Corporate Governance Mechanism and Organizational Performance ($r = 0.526$, $p < 0.01$), strong positive relationship between Communication Strategies and Organizational Performance ($r = 0.601$, $p < 0.01$), moderate positive relationship between Code of Conduct Organizational Performance ($r = 0.444$, $p < 0.01$). Among the Corporate Governance dimensions, Communication Strategies has highest significant positive relationship with Organizational Performance, compared with other dimensions.

According to the table, there is a strong positive relationship between Corporate Governance and Organizational Performance ($r = 0.530$, $p < 0.01$).

Impact of corporate governance on organizational performance

It analyses the influence of Corporate Governance on Organizational Performance. In order to figure out which are important determinants of Organizational Performance consequently in order to assess the relative importance of each Corporate Governance on Organizational Performance, the multiple regression model was used.

Table 5.39 Influence of Corporate Governance on Organizational Performance

Independent Variables	Regression Coefficients
	Organizational Performance
Board Size	0.012
Corporate Governance Mechanism	0.277**
Communication Strategies	0.352**
Code of Conduct	-0.011
Constant	1.600**
Adjusted R Square	0.423
F-Statistics	21.895

** Significant at the 0.05 level ($p < 0.05$)

According to the table, 27.7% of variation in Organizational Performance is explained by the dimension, Corporate Governance Mechanism. Likewise, 35.2% of variation in Organizational Performance is explained by the dimension, Communication Strategies. The above said two influences are significant at 5% significance level. The other two variables, Board Size and Code of Conduct

explain 1.2% and -0.11% variation in Organizational Performance respectively. But their relationship is not significant at 5% significance level.

Out of four determinant variables, Communication Strategies has more influence on Organizational Performance of Financial Institutions in Batticaloa.

While considering the overall impact of the model on Organizational Performance, F-Statistics value 21.895 with 5% significance level reveals that the model is significant. Furthermore, Adjusted R Square statistic is 0.423 which implies that 42.3% of change in Organizational Performance is explained by these four variables.

CONCLUSION AND RECOMMENDATION

This study has been conducted to find the impact of Corporate Governance on Organizational Performance of Financial institutions in Batticaloa district (Manmunai North Divisional Secretariat). It gives conclusion on Corporate Governance. The Financial Institutions are highly Corporate Governed organizations. It means that they succeed in using the Corporate Governance practices in their organization. They have more incorporated with Corporate Governance Mechanism and Communication Strategies at a high level to pursue Corporate Governance. According to the regression analysis, Communication Strategies has highest influence in Financial Institutions in Batticaloa district. It gives the transparency of companies' activities to the all the stakeholders of the companies and an effective communication with the stakeholders that ensures to understand their companies performance. Corporate Governance Mechanism also has highest influence in financial institutions in Batticaloa district. It helps to make a better decision and future planning for companies. However, the results of the study provide that board size and code of conduct have not significantly contributed to organizational performance. It can be suggested that board of directors have to concentrate on their roles to lead the organization successfully. Meanwhile, financial institutions have high level of organizational performance. Thus, these institutions have more concentrated on customer satisfaction and employee commitment. But financial institutions fail to concentrate on corporate reputation. Hence, they should focus on risk of investment and also future growth of companies. The Pearson correlation analysis exposed the strong positive relationship between Corporate Governance and Organizational Performance and also regression analysis confirmed the Corporate Governance influences the Organizational Performance. Simultaneously, it has been found that Corporate Governance impacts the Organizational Performance of Financial Institutions in Batticaloa district.

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