A Review of the Relationship between Corporate Governance and Organizational Performance through Systems Thinking

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ABSTRACT

There seems to be divergent views on the relationship between corporate governance and organizational performance. These views seem to be inconsistent and inconclusive according to some researchers. Why are the views not convincing? What are the possible causes of the inconsistency? Reviewing relevant literature through a systematic approach, it was gathered that various studies approached the subject through different individual attributes of corporate governance with different methodologies in different situations. The works show impact-degree-relationship or directional-relationship or no relationship. It was also found that researchers hardly considered environmental factors in the governance-performance relationship discourse. The study therefore proposes the application of systems thinking perspectives for future studies on the subject. This study corroborates the claim that there exist a relationship between corporate governance and organizational performance. It identifies the lack of standard elements for measuring corporate governance as the possible cause of the inconsistency. Contributing, the study attempted to classify the conclusions of identified works into three assertions to buttress the argument in favour of governance and performance relationship. The study suggests that policy makers and practitioners should take keen interest in not only board attributes but other factors within the organizational environment to identify, analyse, appreciate and address all possible challenges.

Keywords: Corporate Governance, Organizational Performance, Environment, Systems Thinking

INTRODUCTION

Corporate governance (CG) and organizational performance (OP) relationship discourse has not been considered a trending issue among corporate governance researchers, students and practitioners in recent times. It has not been given the needed attention as a factor, critical to organizations. As a result, few researchers have attempted to study this relationship because of the value placed on individual performance and organizational outcomes [1]. For this reason, some scholars have focused on the structures and attributes of corporate governance to project their impact on performance [2], [3] by indicating which attributes have direct or indirect relationship with performance [4]. The results of such studies have been tagged as mixed and inconclusive [5]–[7]. Now the question is how doubtful is this relationship? Are there justifications
for the governance-performance relationship? This study unlike earlier ones does not seek to measure the relationship between CG and OP but to investigate works, which have focused on the relationship between corporate governance and organizational performance. It examines what previous research evidences have told us about this relationship and explores the extent to which the evidences are relevant to the relationship debate. Consequently, the study offers three assertions to support the existence of a governance-performance relationship. Organizational performance still appears to be prone to failure [8] because it also appears that corporate executives [9] have neglected the objectives of corporate governance [10]. Coupled with the initial reason, some scholars have confirmed weak corporate governance as one of the contributing factors to poor organizational performance [2], [3]. However, to be able to rescue the situation, it is advised that Boards of Directors ensure that appropriate rules or regulations, policies, and structures for monitoring and evaluation are executed holistically to promote good and effective administration of management [11]. In short, Boards of Directors in organizations are expected to strengthen corporate governance. Again, it is observed that researchers often relate individual components of corporate governance to performance through internal perspectives and that influences their conclusions. Internal Corporate governance embodies giving preference to owner’s concerns and ensuring that the board checks on top management [7] serving as a link between management and the owners. But this study argues for the consideration of external perspective too [11]. The external perspective ‘examines and controls executive actions’ by means of external policies together with other environmental considerations. This means that external and systemic perspective approaches should be used to study the relationship between corporate governance and organizational performance by taking the former as a whole body and relating it to the latter with external (environmental) factors within and without the organizational system that have interaction with it. In effect, the study argues that the relationship between corporate governance and organizational performance could be better explained if it was approached through external and systemic perspectives. Consequently, this study attempts to contribute to the discourse by presenting a list of conclusions of studies on the subject, discussing them to identify their significance and limitations and arguing in favour of a relationship.

Organizational Performance

The level of an ‘achievement to which an employee fulfils the organizational goals and objectives at the workplace is called performance’ [7]. Performance is often perceived differently by various researchers, but most of the scholars relate performance with ‘measurement of transactional efficiency’ and effectiveness towards organizational goals or objectives [7], [8]. To this end, Ricardo in [8] outlines that performance can improve based on effective management of organizational resources. He further explained that in order to achieve goals and objectives of an organization, strategies must be designed based on organizational performance (OP). According to [12], OP means the ‘transformation of inputs into outputs for achieving certain outcomes’. This implies that OP involves analysing a company’s output of work against its objectives and goals. In other words, OP comprises real results or outputs compared with intended outputs. Developing a high performance organization is an appropriate and achievable goal in today’s business environment. ‘High performance’ organizations are regarded as ‘best of class’ [9]. Such organizations do a lot more rather than ordinary survival. They prosper due to their inherent ability to perform and adapt to greater extent and tougher environments than their competitors. As a result, high performance organizations deliver greater satisfaction and maximum long term value [7] to their stakeholders through the management of available resources. Sustained high performance comes from an organization’s capacity to deliver results [13] in the short term while rapidly adapting to a longer term’s external and internal changes. In relatively stable conditions, creating a high performance organization is a significant challenge. In this regard, conducive organizational environment becomes one factor that can boost OP [14]. To show the relevance of performance to the organization, [15] posited that performance and effective organization have a high degree of collaboration.

Measuring Organizational Performance

According to [16]–[18], there is no general agreement in literature on the standards to be used in measuring OP. However, there are four main dominant approaches which are often used for measuring OP. First is the Goal Approach. This approach explains that organizations are created for certain specific purposes and the purposes are determined by stakeholders (consistent with Stakeholder Theory). The next is the System Resource Approach (consistent with Resource Dependency Theory), which points out the relation between the organization and the environment. [19]
believes in this and asserts that an organization becomes effective when it takes advantage of its environment in the attainment of high value. To this end, [18] affirms that organizations with more control over resources are likely to have the most influence on the performance. The third is the Constituency Approach. According to [20], an organization is considered effective when its multiple stakeholders perceive it as effective. They seem to suggest that performance is a perception. Last but not least is the Competing Values Approach which was developed by [21]. This approach opines that organizational goals are created in different ways by the various expectations of multiple districts (consistent with Social Contract Theory). Therefore, organizations may have different criteria to measure performance. According to [21], stakeholders support the adaptability of their organizations. They want the actors to be flexible, stable and effective. Finally, OP can be classified into three specific areas: (a) financial performance, (b) product market performance and (c) shareholder returns. Ultimately, all of these three classifications can be achieved best where good corporate governance exists.

**Corporate Governance**

Corporate governance, as a concept has varied definitions and describes how organizations are managed or controlled. CG is basically concerned with building trust, ensuring accountability and transparency [11]. It is a system of ensuring an effective way of information disclosure [22], [23] so as to bridge the information gap between organizations and their stakeholders [8] in order to resolve the agency problem [11] and improve performance [2], [10]. CG ensures that responsibilities are clearly defined among all stakeholders in order to facilitate the implementation of policies [11]. [24] offer a concise definition, stating that CG is 'concerned with a collective action resolution for the purposes of promoting improvements in performance’. Where corporate governance mechanisms are non-existent, stakeholders may suffer difficulties of monitoring and administrators or managers may also misuse organizational property or assets to the detriment of shareholders [25]–[27]. When this occurs, it will impact negatively on the performance of firms [11]. Tang & Chang, 2015). This means that managers in organizations with weak CG can easily abuse accounting discretion [7], [25], [28] compared to those in organizations with strong CG. Therefore, CG demands that managers become competent, proficient and skilful in conceptual thinking, goal setting [7], [11] and developing strategies to arrive at suitable decisions. In CG, Boards of Directors (BoDs) are expected to provide guidance, direction and create conducive environment that encourages management [7] and staff to work effectively for performance maximization [26] and wherever this exists, good CG exists. Good CG is based on the principles of integrity, openness and accountability [29] and promotes sound internal control systems, risk management, compliance with ethical and statutory requirements, ensure transparency [11], accountability and trust in the management of organizations [30]. Good CG involves good management judgment and compliance [4] to boost investor confidence in organizations [25], [31], [32]. Similarly, good governance is also the expectation and confidence of even the yet-to-be investors of the organization. Hence, the primary role of CG towards achieving good performance is the provision of good governance or good leadership. Good leadership is one of the vital factors for improving performance in organizations. Leaders, as the key decision-makers determine the acquisition, development, and distribution of organizational resources, the conversion of these resources into valuable products and services. Good leaders provide opportunities for the staff to perform their work effectively. They are also responsible for guiding, mentoring and coaching their subjects in the organization to achieve the target results. The background to the formation of companies or organizations indicates that public companies were created through ‘incorporation’ as legal entities which were separate from their owners (dating back to 1844). A company became a legal ‘person’ which could employ people, enter into contracts, sue and be sued [33]. The company was viewed as a ‘little republic and a miniature political system’ in which all its members including shareholders, had rights to representation, information and decision-making [10], hence, the birth of corporate governance. CG rests on theories. These theories of CG started with the agency theory, which extended into stewardship and stakeholder theories [34]. Later, these evolved to resource dependency theory, political theory, legitimacy theory and social contract theory [7]. All these theories provide a way by which an organization is viewed, the function of the various elements and their relationship in the organization.

**Agency Theory**

The principal-agent theory is generally considered the starting point for debates on the issue of corporate governance. According to this theory, the fundamental agency problem is the separation between the principal (owners) and the agent
(management). Jensen and Meckling in [35] describe this relationship as a contract under which a principal engages an agent to perform some service on the principal’s behalf, which involves delegating some decision-making authority to the agent. The gap that is generated by the separation induces fear. Fear that professional managers (agents) cannot be held accountable by the widespread shareholders and that the agent may extract ‘perquisites’ (perks) out of an organization’s resources. This problem causes the principals to be confronted with two main problems – selection of the most capable managers and how to prevent moral hazards in the organization. To address this, efforts have been made to look into composition of board of directors and CEO duality. The board of directors is expected to be made up of more non-executive directors (NEDs) for effective control, reducing conflicts of interest and ensuring a board’s independence in monitoring and passing fair and unbiased judgment on management. On the other hand, CEO duality is expected that different individuals occupy the positions of CEO and board chairperson as this will reduce the concentration of power in one individual and thus greatly reducing undue influence of particular management and board members.

**Stewardship Theory**

This theory argues against the agency theory that managerial opportunism is not relevant [26]. It argues that a manager’s purpose in an organization is to maximize performance. The theory stipulates that the positions of CEO and board chair should be concentrated in the same individual as against the stance of agency theory. The reason is that it affords the CEO the opportunity to carry out decisions quickly without the hindrance of undue bureaucracy. Finally, it argues that ‘small board sizes’ should be encouraged to promote effective communication and decision-making. Though this theory tries to replace the lack of trust and kill the fear that the agency theory generates with regard to unaccountability and unethical behaviours, it fails to define the ‘smallness’ of board size.

**Stakeholder Theory**

The stakeholder theory stipulates that a corporate entity invariably seeks to provide a balance between the interests of its diverse stakeholders in order to ensure that each interest constituency receives some degree of satisfaction [10], [36]. The stakeholder theory appears better to explain the role of corporate governance than the agency theory by highlighting the various components of an organization. Thus, owner, BoDs, staff, governments and society are regarded as relevant stakeholders [37], [38] The stakeholder theory also emphasize the role of size of the boards and committees structure as important to performance. However, it has become more prominent because many researchers have recognized that the activities of a corporate entity impact on the external environment requiring accountability of the organization to a wider audience than simply its shareholders [36]. To this end, is should be noted that companies are no longer the instrument of shareholders alone but exist within society and, therefore, has responsibilities to that society [36], [39].

**Resource Dependency Theory**

This theory indicates that the firm’s presence on the boards of other organizations is relevant to establishing relationships in order to have access to resources in the form of information which could then be utilized to the firm’s advantage. In other words, this theory shows that the strength of a corporate organization lies in the amount of relevant information it has at its disposal. The theory points out that, organizations usually tend to reduce the uncertainty of external influences by ensuring that resources are available for their survival and development. By implication, this theory seems to suggest that the issue of dichotomy between executive and non-executive directors is actually irrelevant [37]. Consequently, all four theories mentioned above underscore Boards of Directors as an essential element in CG. The corporate board could be identified as panacea to addressing the corporate challenge. No wonder BoDs have become a central subject of study so far as corporate governance is concerned. Most researches in CG focus on the BoDs – their features and activities in the organization. In other words, to study corporate governance means to study the BoDs.

**Measuring Corporate Governance**

Corporate boards are responsible for major decisions in an organization. For example, decisions like changing by-laws, issuing of shares, declaring of dividends among others. This explains to some extent, the reason why discussions of corporate governance usually focus on boards. The board of directors is the ‘apex’ of the controlling system in an organization. Therefore, to measure corporate governance has caused researchers to focus on measuring the attributes of BoDs, and their function. But is it the mere existence of the structures or attributes that count? CG should be linked more to duty rather than mere structures. This means that meeting the attribute-requirements alone is not a panacea to good
governance. The most important thing is commitment to duty. Research has not established a common set of elements to be used as measuring variables for CG. Different researchers use different ‘BoD’ attributes as proxy to measure CG and this creates inconsistency [2], [7], [40]. Such attributes include board size, female representation on boards (gender), CEO duality, board independence, board composition and more. However, we think that CG should not be measured in isolation. The environment within which BoDs operates with emphasis on their function should be factored, in other words, approaching the study or practice of CG with systems thinking perspectives.

**Systems Thinking**

Systems thinking implies a way of thinking whereby a system is understood in relation to its surrounding world [41] or environment. A system may refer to an organization, object, a program or concept. Elements within a system share some interaction or interdependency. In this regard, we perceive an organization as a system – a body of several elements which interact together to perform a common function or relate to each other to achieve a common goal within an environment. By this, we adopt Bertalanffy’s definition [7] that a system is ‘a complexity of interacting elements’ within a given environment, where ‘interaction’ means the relationship between elements’. Environment means a collection of outside of the world of a system and its associated things. Therefore, when CG is measured considering the environment of the organization, results generated would be better [5]. Understanding the dynamics of a system can be viewed through both external and internal perspectives [41]. The external perspective approach considers a system as a singular whole entity and focuses on its overall characteristics, the nature and trends of its environment, the dynamics of its interactions with its environment and its evolution over time while the internal perspective approach involves examining a system’s internal functioning and considering all of its component elements, the dynamics of how they interact and how they are integrated into a singular whole entity [41]. These perspectives are consistent with the holistic approach which requires the integration of all influencing factors into an overall representation of a situation [41]. Hence, we agree with Heracleous in [7], that to relate corporate governance to organizational performance, one needs to adequately consider systemic influences or other linkages, lest such an attempt is ‘bound to produce weak and inconsistent results’ [2], [7]. Find below a framework suggesting the relationship between CG and OP. In Figure 1, the main variables or elements proposed to underscore the relationship are Corporate Governance, Management and staff, Organizational Performance and Environment. Three variables are part or elements of ‘system’ or the organization. Though a system may have other important elements within it, which help it to function, such other elements have been intentionally muted so as to project the named ones. Another key feature of the framework is that though corporate governance could be considered as systems, it is here considered as element of the organization. Furthermore, the framework exhibits different kinds of relationship such as directional, corresponding and impact (significance). The positive sign connotes good governance or high performance but the negative sign connotes poor governance or low performance. The boundary sets the limits for the system. It is identified that the organization (system) and the environment have correlation effect on each other but this will be considered in a future research.

![Diagram](http://onlinejournal.org.uk/index.php/ajmur)

**Fig.1:** Systems Elements Relationship Framework (Source: Authors)

Apart from illustrating the interaction between the elements, the model can be expressed mathematically as \(a(b + c) = d(a)\) to explain the impact of the independent variable (corporate governance) on management and performance. In the equation, \(a\) is constant and represents environmental factors \((EnvF)\), \(b\) is independent variable and represents corporate governance \((CorG)\), \(c\) is dependent variable and represents management \((M)\) and \(d\) is results or outcomes and represents organizational performance \((OrgP)\).

\[
EnvF(CorG + M) = OrgP(EnvF)
\]

Note that corporate governance quality may be positive or negative. And in each case, the quality of Management (strategy and implementation) will be affected. This means that improvement or decline in the quality of corporate governance ensures an
improvement or decline in the quality of strategy and implementation which together with its environmental factors result in rise of fall of organizational performance.

METHODS
It is agreed universally that there are primary and secondary data. This study adopted the latter, which covers information gathered from textbooks, theses and journal articles, statutory and non-statutory documents through a systematic review approach. As a result, a search was conducted across relevant library and external sources including Google, ABI/INFORM® (ProQuest, Ann Arbor, MI, USA), SciVerse® ScienceDirect® (Elsevier, Amsterdam, the Netherlands) and the Social Science Research Network, from 2010 to 2019. The search retrieved over a thousand results using some phrases as ‘relationship between corporate governance and organizational performance’, ‘corporate governance and firm performance’, ‘corporate governance and performance’, ‘good governance and performance’, ‘organizational performance’, ‘corporate governance’ and others. The related and relevant literature was downloaded after scheming through the titles. Afterwards, thorough selection process was carried out with the inclusion and exclusion criteria that were set for literature gathering. The inclusion criteria were that literature must be relevant to subject, journal articles must fall within the year range of 2000 to 2019, however, older but very relevant literature was accepted. Any literature that fell outside the criteria was ignored. This scaled down the number to a bearable size of 59. The finally selected literature was read and the needed information was churned out through a realist approach to an evidence based synthesis of literature. The findings were tested, honed, refined and used for the composition of the study. The study adopted subjective approach discussion.

DISCUSSION
Though some studies argue for nonexistence of a correlation between CG and OP, such studies are few. And even in that case, they assert that some (not all) CG attributes have no significant impact on OP. For example, it is reported that ‘there’s no significant impact for ownership of the largest shareholder and independency of Board of Directors on firm's market performance’ [42]. Similarly, [42] also stated in their work that ‘there is no significant impact for corporate governance adoption on firm's operational and financial performance’. However, there is also the argument for no right or wrong model in corporate governance and that the practice of good CG does not guarantee high performance as stated by Chambers & Cornforth in [7] but Gillies and Morra hold a contrary view and posit that common sense tells that there’s a correlation between CG and OP. To Gillies and Morra, the correlation or relationship between CG and OP should not be a subject of debate. The answer is obvious. But the question is how convincing is the argument of the relationship established? To this end, our study presents three projections with sample of findings from empirical works to corroborate the argument for existence of a correlation between CG and OP.

Assertion 1: There is a relationship between corporate governance and performance
Research outcomes on the subject argue with divergent views [43] and Chambers & Cornforth in [7], be it empirical or theoretical. Despite the stance ‘against’ the debate, there is enough evidence to support the argument for existence of a correlation between CG and OP [44] including economic performance of nations [45] and this is why companies are trying hard to inculcate the practice of good CG [46] in spite of the dilemma to maximize output. The works of [2], [4], [27], [40], [47], [48] and [49] confirm the existence of a relationship between CG and OP. Their works corroborate the earlier position of Gillies and Morra that ‘common sense tells us that there is a relationship between corporate governance and firm performance’. In their works, they used expressions such as ‘positive or negative impact’ to show the degree of the correlation and ‘direct or indirect impact’ to show the directional nature of the relationship [45]. For example, it has been identified in leadership studies that effective human resources management mediates the relationship between leadership and performance through increased commitment, higher motivation and intellectual motivation [50]. This means that though there is a relationship between leadership (CG) and performance, this relationship is indirect. To buttress the CG and OP relationship, [51] emphasized that transformational (good) leadership (CG) relates positively and significantly to organizational performance basing his assertion on a research conducted on 151 companies from IT industries. Similarly, numerous studies have stated positive relationships between good leadership and outcomes at the individual level and firm levels [52] and [53]. A study conducted on 170 companies from Singapore on the connection between leadership style and organizational performance identified a positive relationship between leadership and organizational performance. It argued that many empirical studies
have reported that leadership (CG) has an impact or (and) directional relationship with performance or firm outcomes [54]–[56].

**Assertion 2: Good corporate governance promotes high performance and vice versa**

Besides the category of studies which holds the first assertion is another category of works which purport that good corporate governance promotes high performance. The reverse is also true. Assertion 2 indicates that the quality of a CG has a corresponding quality effect on OP. This assertion is evident in the expressions found in some empirical works: ‘effective corporate governance system results in high performance’ Changezi and Saeed, in [7]; ‘better governance contributes to higher provisions and reserves of financial institutions’ [47]; ‘best practices of corporate governance boost the economy and thus improve the performance of the national economy’ [45]; ‘better governance increases the sensitivity of firm profitability to industry profitability’ [57]; and ‘weak corporate governance was a contributing factor to poor performance’ Olannye and David in [7]. Here, special notice is placed on the careful use of adjectives (effective, better, best practices and weak) to modify CG while their corresponding adjectives (high, higher and poor) were attributed to OP. However, the use of some verb phrases like results in, contributes to, boost, improve and increases helped to establish the assertion. The proposed model ‘Systems Elements Relationship Framework (SERF)’ showed in Figure 1 gives a diagrammatic explanation of the CG and OP interplay. The model projects two positions. First is the position that good CG promotes high OP and the reverse. This position that good governance promotes high performance and high performance promotes good CG may be true in the sense that shareholders, managers and board members are motivated by high performance. This may encourage the setting of higher targets by boards, provision of more resources to management and yielding of more dividends to shareholders. It has been observed that where there is high performance, actors become high spirited to work hard and achieve more. In this direction, board members would be confident to apply all the necessary principles and strategies while management and staff would be highly motivated to implement plans and strategies. In effect board members may gain the confidence of shareholders. The second position shows that good CG may correspond to high OP while poor CG may correspond to poor OP (where constant is always positive). However, the latter position may change (where constant becomes negative). This means that environmental circumstance which is always constant, depending on its positive or negative form predicts the corresponding impact of CG. This suggests that improved governance can even be affected by a negative environmental circumstance to alter performance. Notwithstanding, the position of both the model and the assertions have not been tested and therefore, it is recommended for further studies and investigation.

**Assertion 3: Some governance attributes have positive or adverse impact on performance**

Most corporate governance literature place emphasis on the study of board attributes. Such attributes include CEO duality, board size, information disclosure, ownership, board composition, audit committee size, female gender representation and more. In several cases, such attributes are used as proxy for measuring corporate performance. Though these attributes are used in different ways with different methodologies, they exhibit different impact relationships on performance. For example, [58] concluded in their work that ‘CEO duality and board dependence negatively affect performance’. Similarly, [7] found that ‘CEO duality has statistically significant negative impacts on firm performance’. We also found in another work that ‘corporate governance through ethical behaviour has positive effect on employees’ productivity’ [8]. In other sampled empirical works it was identified that ‘corporate disclosure practices have positive effects on company performance and negative effects on company leverage’ [48]; ‘Significant impact was found for the ownership and the size of the Board of Directors on firm's performance’ [42] ‘Board size, Board composition and audit committee size have significant effect on return on capital employed’ [11]. ‘Once board conflict is resolved, organization performance changed by 7%’[26]. These examples shown above give credence to the fact that board attributes are often used as proxy to measure corporate governance and also to demonstrate the sort of effect the attributes have on organizational performance (positive or negative, significant or insignificant). Ultimately, this assertion also supports the argument that there is a relationship between CG and OP by demonstrating how and the nature of relationship.

**CONCLUSIONS AND RECOMMENDATIONS**

In recent years, the public has demonstrated great concern by calling for sanity in organizations as a result of corruption and underperformance. This has
necessitated the need for reforms in the entire field of Corporate Governance system [43] in the global arena. However, it appears that corporate executives [9] have neglected the objective of CG [10] despite the looming tendency that organizational performance still appears to be prone to failure [8]. According to literature, CG is examined from two points of view; the narrow (internal) and the broad (external) perspectives [11]. The narrow perspective looks at the structure within which organizations are directed while the broad perspective focuses on both market and society [11], [29]. Internal Corporate governance gives preference to owner’s concerns and ensures that the board checks on top management [7] serves as a link between management and owners but the external corporate governance ‘examines and controls executive actions’ by means of external policies about other stakeholders [11] - customers and society in general. Next, the study identified three weaknesses in the approaches of researchers to the subject under consideration. First, they use board attributes as proxy for measuring CG since there are no standard elements for measuring CG. Second, researchers relate individual elements of board attributes to performance [59] as if it is the mere presence or existence of the CG structures that influence performance. Instead, researchers must place more emphasis on duties of the board as a way to measure performance. We think that it is possible to have all the CG structure in place without seeing good performance in an organization. Finally, it is identified that almost all considered works on the subject in question have been pursued without considering the external environment of the organization. Consequently, the study concludes that there is a relationship between corporate governance and performance [2], [4], [27], [47], [49]. CG and OP have directional and impact relationships. Also, the study concludes that good corporate governance promotes high performance while poor governance leads to poor performance. In other words, CG quality and OP quality have direct corresponding relationship [57]. The last but not least of the conclusions is that some governance attributes have positive or adverse impact on performance [7], [11], [26], [42], [58]. In view of this study, we confirm the existence of a relationship between CG and OP and support the argument that the relationship discourse has not been conclusive and convincing [5] due the weaknesses identified in the early studies [2], [7].

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