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Economics, Business and Contemporary Discussions in Social Science

# CONFERENCE PROCEEDINGS

## Barcelona 2023, Spain

Full Paper Series


Editors

Kemal Cebeci
Irina Ana Drobot
Antonio Focacci


HCC St. Moritz
Barcelona, Spain
21-22 November 2023

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**Education**: Research & development in education, technology and education, education strategies for different age groups, life time education, pedagogy, learning and teaching, educational psychology, curriculum and instruction, e-learning, virtual learning, global internet courses, blended learning, flipped, pathway, enabling, work integrated learning, executive training, training and development, educational leadership.

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**European Studies:** EU crisis, monetary union, enlargement process of EU, tax harmonization in EU, fighting with tax competition in EU, EU energy policy, competitivenes, EU social policy , Fighting unemployment, income distribution, EU migration, understanding migrants and asylum in European Union, european migrant crisis, refugee crisis, social reflections of Syria crisis to EU area, cooperation for improving EU, Brexit, future projections, EU environment policy and resource efficiency, EU relations with third party countries, climate change and EU, integration, culture.

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**Globalization studies:** Framework of globalization, history of globalization, economic globalization, cultural globalization, political globalization, globalization and international law, globalization and arts, globalization and conflicts, globalization and new world order, sustainable growth and development, globalization and climate change, regional integrations, human rights and globalization, migration, global institutions, technological platform for globalization, national boundaries, globalization and internet, globalization and sports, globalization and free trade.

**Health:** Public health, health policies, hospital management, public and private health services, economic, social and political aspects of health services.

**International Business**: Culture and business, regional-global business, entry modes, strategy, expansion, mergers & acquisitions, trade, franchising strategies.

**Internet & Social Media Studies:** Social media, internet, future of communication.

**Management**: Human resources, cultural problems in labor mobilization, international human resource, mobility of human resource, business, cross cultural, corporate governance, financial resources, gender issues, technological resources, natural resources, knowledge.

**Marketing:** New media, social media marketing strategies, international, consumer research, market research, policy research, sales research, pricing research, distribution, advertising, packaging, product, media.

**Philology, Language & Translation Studies**: Historical study of language, aspects and research of speech production, transmission reception, linguistics, translation studies.

**Social Business**: Socially responsible enterprise, environmentally conscious enterprise, non-government institutional activities, globalization and social business, care programs.

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**ANA MARIA QUARESMA[1] AND SANDRA RIBEIRO[2]**

## PILLARS OF CORPORATE GOVERNANCE: A POSITIVE EXTERNALITY OR NOT?

**Abstract**

Corporate Governance is based on pillars of Transparency, Fairness, Responsibility and Accountability. Companies listed on the Stock Exchange are subject to high corporate governance requirements, which are reflected in their good, or bad, performance in their share prices. In Microeconomics, Externalities is the word used to describe the effects related to the production/consumption of a good/service that are not captured by the market, more specifically by the price system.

This exploratory study aims to review the literature to show whether the pillars of Corporate Governance can be considered as a positive externality. Regarding Transparency, Fairness and Responsibility it was not possible to verify that they represent a positive externality because their adoption is reflected in the share prices, however, and given that Accountability is mandatory in listed companies, it would be impossible for organizations to remain listed on the Stock Exchange if they did not comply with the requirements imposed. Thus, we conclude that this pillar can be considered a positive externality, allowing all economic agents to benefit from the financial information of the organizations.

**Keywords:** Corporate governance pillars, positive externalities, accountability

**JEL Codes:** M10, M16

Quaresma, A. M. & Ribeiro, S. (2023). Pillars of corporate governance: A positive externality or not?. In Conference Proceedings: Full Paper Series of MIRDEC 21th - Barcelona 2023 International Academic Conference on Economics, Business and Contemporary Discussions in Social Science, pp. (119-127). 21-22 November 2023. Barcelona, Spain. https://www.mirdec.com/barca2023proceedings.

## 1. Introduction

Good Corporate Governance Practices are pillars for the success of companies, and for the market valuation of listed companies in particulary, contributing strongly to investors' confidence.

According Hussains (2018) the global discussions about corporate scandals have recently escalated the need to investigate corporate policies, strategies, and practices.

Good corporate governance practices are to be stranded on a clear and dynamic legal and enforceable and backed by effective execution organizations (OECD, 2004a). The OECD Principles of Corporate Governance establishment of an effective system of inspections and equilibriums between boards and management. To avoid possible abuses, professional managers should be effectively monitored by the board. The board is in turn responsible to the shareholders, who should be able to exercise their fundamental ownership rights, including appointing and removing board members. Lastly, to effectively use ownership rights to monitor and influence the board needs essential requirements of disclosure and transparency (OCDE,2004b).

The OECD principles focuses on six key areas of corporate governance. Table 1 summarizes the main areas of OECD Principles with short descriptive explanation. (OECD, 2004b).

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**Table 1. Principles of Corporate Governance**

| | |
|---|---|
| **I. Ensuring the basis for an effective corporate governance framework** | Good practices of corporate Governance should promote transparent and efficient markets, be coherent with the law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities. |
| **II. The rights of shareholders and key ownership functions** | Good practices of corporate governance should protect and facilitate the exercise of shareholders' rights. |
| **III. The equitable treatment of shareholders** | Goode practices of corporate governance framework should ensure the equitable treatment of all shareholders. |
| **IV. The role of stakeholders in corporate governance** | Good practices of corporate governance should recognize the rights of stakeholders established by law or through mutual agreements and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises. |
| **V. Disclosure and transparency** | Good practices of corporate governance should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company. |
| **VI. The responsibilities of the board** | Good corporate governance practices should ensure compliance with organizational strategy, effective management control by the board of directors and management accountability. |

Source: Principles of Corporate Governance (2004b).

The basis of the above-mentioned principles are the pillars of good corporate governance (accountability, transparency, responsibility, and fairness): which will be analyzed in section 2.1.

The other theoretical framework exposed on this study is the positive externalities. Externalities is the word used to describe the effects related to the production /consumption of a good/service that are not captured by the market, more specifically by the price system (Pindick et al, 2018).

Positive externality can be associated with good corporate governance practices. The understanding of the positive impact of these practices on society, bringing beneficial effects that affect all individuals in general, even those who are not shareholders and even stakeholders of the organization.

The main proposal of this study is understanding which pillars of corporate governance can be considered a positive externality. For this comprehension, in section 2.2 we will theoretically expose the

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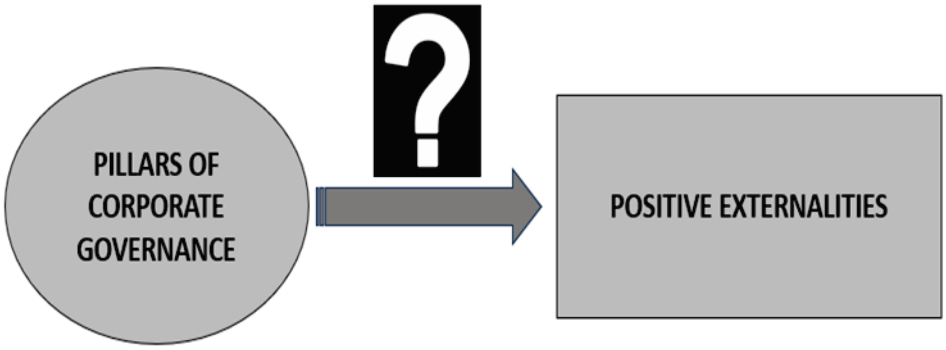
externalities. The scope of this study is to understand which pillars of corporate governance can be considered positive externalities (see figure 1) that will be discussed in the final considerations.

**Figure 1. Scope of the study**




Source: Made by the authors.

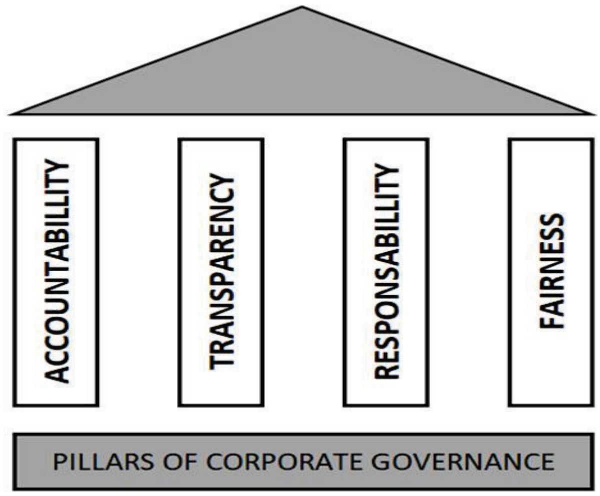
**2. Theorical Background**

In this section the theorical fundamentals for this study will describe. By one hand the companies, in particular listed companies, must comply with the principals of good Corporate Governance, sustained by four pillars (see section 2.1), on the other hand we try to understand the positive impact on the society in general. The scope of the study is the comprehension if this positive influence can be considered, or not, a positive externality.

**2.1. Pillars of Corporate Governance**

The four pillars of corporate governance (see figure 2) provide a framework for good corporate governance by organizing transparency, accountability, fairness, and responsibility in companies' behaviors. The adoption of these principles, organizations can increase stakeholder trust, mitigate risks, and achieve sustainable growth.

**Figure 2. Four Pillars of Corporate Governance**




Source: Made by the authors.

**Accountability:** involves holding company management and the board of directors responsible for their actions and decisions. This includes ensuring that they act in the company's and its shareholders' best interests and that they are held accountable for any breaches of laws, regulations, or ethical standards. The term accountability is associated with attributing to someone the consequences of their actions. Stakeholders need to feel that if something goes wrong, or if it does, managers will have to be accountable for their actions. Investors are driven to invest in organizations with the knowledge that future actions, whether successful or unsuccessful, are properly accountable. This pillar promotes transparency and integrity in the management of organizations, fostering stakeholder trust. The management of organizations is responsible for their financial performance and following the law (OECD, 2023).

For listed companies is **mandatory by low publishing the Financial Accounts** who must be Certificate by an External Auditor.
The companies must Comply or Explain.

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**Transparency:** this is another crucial pillar of good corporate governance, which underpins that the management of organizations must act in an open and transparent manner, providing the necessary information for stakeholders to monitor corporate life. Transparency is not only revealed in the disclosure of financial information, but also in business operations, risk, corporate structure, and other matters that can influence the opinion of interested parties about corporate management. Transparency and accountability are two fundamental pillars of good corporate governance, but while transparency is guided by good practices and, obviously, if it is not complied with, the impact on the market price of shares is negatively affected, accountability adds that this disclosure is required by law.
This pillar promotes transparency and integrity in the management of organizations, fostering stakeholder trust. The management of organizations is responsible for their financial performance and following the law.


Companies must be open and willing to provide timely information on the company's financial, social, and political position to shareholders, stakeholders, customers, and the public. The management reveals good corporate transparency with a functioning audit committee, routine external audits, and objective, accurate yearly reports (OECD, 2023)

**Responsibility:** focuses on organizations that act in a socially and ecologically responsible manner. The management of organizations must consider that their decisions affect society, the environment and future generations. In this way, ethical and sustainable corporate practices, such as minimizing negative environmental impacts, promoting diversity and inclusion, defending human rights and improving the well-being of the community are aspects that fall under this pillar of corporate governance. Responsability also entails interacting with stakeholders and responding to their questions and requirements, leading to the creation of corporate governance (OECD, 2023).
Responsibility moreover involves interacting with stakeholders and responding to their questions and requirements, leading to the creation of communication channels between the organization and stakeholders. Organizations must be transparent about their social and environmental performance and progress towards sustainability goals and be willing to be held accountable for their actions. This pillar is also associated with the social responsibility of organizations, which leads to greater community support, branding and customer loyalty, and the valuation of organizations in the market revealed by the price of their sharescommittee, routine external audits, and objective, accurate yearly reports.

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**Fairness:** Fairness means "treating all stakeholders equally and ensure their rights. The good practices of corporate governance should protect shareholder rights and ensure the equitable treatment of all stakeholders, including minority and foreign shareholders. Organizations should respect the right of shareholder and encourage them to exercise their rights. Fairness is a crucial tenet of corporate governance because it guarantees that businesses including shareholders, employees, clients, suppliers, and communities (OECD, 2023).

Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders of listed companies, also known as the Shareholder Rights Directive, was a milestone in the regulation of corporate governance in the European Union. It recommends that listed companies allow each share to be assigned one vote, encouraging the participation of minority shareholders in general meetings.


**2.2 Externalities/Positive Externalities**

The conceptualization of externality is not absolute. However, they are costs or benefits resulting from an activity and that they are imposed on third parties, but they are not part of the market mechanism. Externalities occur when an agent improves or worsens the situation of another agent, but without assuming the benefits (in the case of improvement) or the costs (in the case of worsening) of doing so (Varian, 2006).

In perfectly competitive markets, there are no externalities. Externalities are present in a market if the actions of consumers or producers generate costs or benefits that are not reflected in the price of the product in the market. With the costs and benefits that affect at least some decision-makers differ from those of society. The market price may not reflect the social value of the good, and the market may not maximize the total surplus. Because they result in economic inefficiency, public goods and externalities are often identified as sources of market failures. Externalities can be negative or positive and can be caused by producers or consumers. if they impose costs on, or reduce benefits for, other producers or consumers (Varian, 2006).

We can identify externalities that occur on the production/consumption side of a good/service.

Examples of negative externalities of production are pollution of a company in the community and negative consumption, listening to loud music and bothering neighbors, smoking in restaurants, etc. In contrast, examples of positive externalities of production are, for example, the development of a new technology, such as the laser benefits not only the inventor but also many other producers and consumers in the economy and as a positive externality of consumption A positive externality of consumption is, for example, when a child is vaccinated to prevent the spread of a disease from increasing, that child

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receives a private benefit, because immunization protects you from contracting the disease. In addition, because it decreases the likelihood of her transmitting this disease, the other children in the community also benefit (Besanko, 2020)

It is not the purpose of this study to make an in-depth microeconomic analysis on this topic, but rather to relate the concept of externality with the pillars of corporate governance discuss on the next section.

**3- Final Considerations**

Analyzing the issue of externalities:

- Negative externalities occur when the effects not considered when the decision to produce/consume are negative and affect third parties who are not related to it.. **According to this Corporate Governance Pillars are not a Negative Externality.**
- Positive externalities, in contrast to the previous ones, in which the effects not considered are positive and should therefore be encouraged. One of the most common examples is support for research, the results of which can contribute to improving certain aspects of the surrounding society.

Pillars of corporate governance are, or not, positive externalities?

According with the previous expose we consider that regarding the pillars Transparency, Responsibility and Fairness was not possible to verify that they represent a positive externality because their adoption, or not, is reflected in the share prices.

Accountability is mandatory in listed companies. It would be impossible for organizations to remain listed on the Stock Exchange if they did not comply with the requirements imposed. Therefore, we consider that for this mandatory imposition the pillar of accountability is considering a positive externality.

These considerations are based on understanding whether the pillars of governance can have a positive impact on the community and not only on its stakeholders, plus the fact that this impact is not manifested in stock market prices (see table 2).

**Table 2. Final Considerations**

| PILLARS OF CORPORATE GOVERNANCE | Positive Impact on the Economy | Impact on Market Prices | Mandatory by the law (listed companies) | Positive Externality |
|---|---|---|---|---|
| Transparency | YES | YES | NO | NO |
| Responsability | YES | YES | NO | NO |
| Fairness | YES | YES | NO | NO |
| **Accountability** | YES | NO | YES | **YES** |

Source: Made by the authors.

All the Pillars of Corporate Governance have a positive economic impact, as their adoption by companies has a beneficial effect on economic agents, however the conduct in terms of **Transparency, Responsibility and Fairness** impact the share price and thus we **do not consider it a Positive Externality**.

**Accountability**, as it is mandatory by law in listed companies, the price of the shares is not influenced, since its non-adoption would invalidate the company's permanence on the Stock Exchange and, therefore, we can conclude that it **is a positive externality**.

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