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The Relationship between Corporate Governance and Firm Performance in Japan and South Korea

Topic and Research Question

In this thesis we aim to analyse the relationship between corporate governance and firm performance in Japan and South Korea. Due to a major corporate scandal of the Japanese manufacturer Olympus, Japan has been strongly criticised for its corporate governance practices as there are some discrepancies in comparison to international standards especially in regards to board characteristics, accountability and corporate social responsibility. It has been suggested that this could be a major reason for Japan's weak economic performance over the last years. Internationally there has been an apparent shift towards more board independence, separate leadership and disclosure. Furthermore there appears to be a consensus that this path leads towards good corporate governance and better firm performance. However there is still no actual proof that this is a valid assumption. Thus the aim of this thesis is to examine if there is a significant relationship between corporate governance and firm performance in order to see if bad corporate governance can potentially lead to bad firm performance and vice versa.

The specific research questions of this study are:

1. What is the relationship between corporate governance and firm performance in Japan and South Korea?
2. How is corporate governance defined and how did it evolve?
3. How did corporate governance practices in Japan and South Korea develop and how are they applied today?

State of the Art

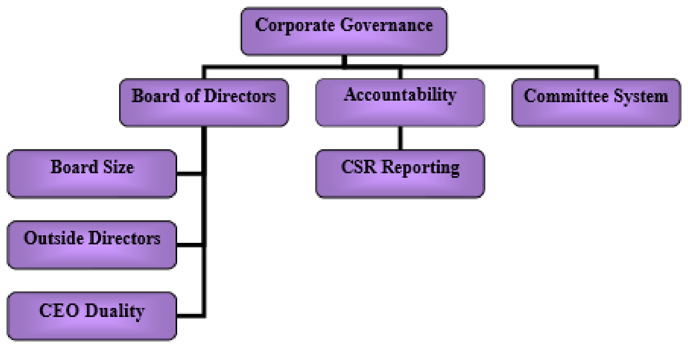
Literature shows differing relationships between corporate governance, corporate boards and firm performance. Some results show negative relationships (Yermack 1996) others show positive relationships (Schleifer and Vishny 1997) and some show no significant relationship at all (Bhagat and Black 2002) between the different variables of corporate governance and firm performance. However even those that indicate for example a positive relationship between corporate governance and performance variables differ in regards to which variables show this significant relationship and if this relationship is positive or negative.

Therefore it is challenging to draw an ultimate conclusion as results differ even within the three categories of results.

Methodology and Approach

In order to answer our research questions we explore, first of all, the different theories of corporate governance. We describe and evaluate theories developed by different authors and the different models such as the two most common models (shareholder model and stakeholder model) but also at other influential models like the resource dependency theory and the stewardship theory. Subsequently we examine different aspects of corporate governance and develop factors to analyse corporate governance in both countries hereby focusing on board structure. In order to evaluate firm performance we find common indicators of firm performance. Subsequently we identify definitions, principles and benefits of corporate governance. We explain the Japanese corporate governance system as well as the system in South Korea.

Our framework of analysis focusses on the characteristics of the board of directors and corporate reporting including corporate social reporting, in more detail: the size of the board, its composition (especially the number of outside directors), the separation between the chairman of the board and CEO and the question of the committee system. As the significance of corporate social responsibility has increased over the past years, this factor is added to our framework of analysis.



Firm performance is measured through accounting-based measures, namely return on equity (ROE) and return on assets (ROA) as they represent two of the most common ratios for financial performance.
For our analysis we use quantitative measures. We present descriptive statistics and conduct correlation and multiple regression analysis' for every single year, as well as panel data analysis' for the whole time period. Data is collected from secondary sources such as annual reports and information found on the companies' homepages. We collect data for listed firms on the stock exchange for 30 companies in Japan and South Korea from 2008 to 2012, respectively.

Main Facts

Corporate governance has been a subject of vivid discussion in Japan over the last years. The burst of the economic bubble was followed by a series of corporate scandals and illegal behaviour and the following bankruptcies of certain companies laid open severe flaws in the Japanese corporate governance system when compared to the Anglo-Saxon system. There was very little capital market orientation. Furthermore the government and banks but also entrepreneurs' associations were major players in the past. These days these instances are losing influence and a corporate governance reform in 2003 seems to have brought Japanese corporate governance closer to the Anglo-Saxon system. Over the years boards have diminished in size and gained more outside directors. Capital market orientation has risen as well as the number of mergers and acquisitions. Nevertheless in reality Japan is still far away from international corporate governance standards. Many of the changes are not applied correctly and many of the reforms only touch the surface. For example there is still no mandatory law determining the required number of outside directors. Japanese companies remain strongly influenced by old practices and habits.
In South Korea the Asian financial crisis led to strong structural and economic reforms as before the crisis the chaebol were severely mismanaged and kept expanding their companies into unrelated markets with no regard for actual profitability. Furthermore they were receiving numerous bank loans without any fixed repayment dates. Due to the reforms the country transformed from an insider to more of an outsider model, introduced a mandatory majority of independent directors as well as the committee system based on the Sarbanes-Oxley Act. It introduced minority shareholder protection and banks lost in influence. However all of these changes happened over a very brief time span and have not had the time to root yet. In addition law enforcement in comparably weak in South Korea. Further reforms are necessary as there remains a large gap between regulations and actual application. But for all that South Korea has made significant progress over the last decade.

Results

According to the results of our descriptive statistics the average of board characteristics did not change much over the course of five years for both countries. Japanese boards were on average larger in numbers than South Korean boards however South Korean boards disposed of a larger number of outside directors than Japanese boards. On average more Japanese companies practiced corporate social reporting than South Korean companies. They equally had a larger percentage of separation of CEO and chairman. Board committees have become mandatory for most South Korean companies. In Japan on the other hand this can be introduced on a voluntary basis. Many companies prefer to introduce certain committees but avoid the audit committee system. ROA and ROE have varied over the course of five years for both countries.
Our correlation matrix' results did not show any significant relationships (which require a correlation of 0.80 in order to be truly significant) between our performance indicators and our governance indicators for any of the years for both countries.
Multiple regression analysis for both countries did not show any significant relationships with a p-value of 0.05 or below. Panel data analysis' (random effects model) did not find any significant relationship between independent and dependent variables for both countries.

To conclude this study could not find any significant relationship between corporate governance variables (board size, number of outside directors, CEO duality, board committees and corporate social reporting) as defined in this study and firm performance represented by ROE and ROA.

References

All references can be found in the full version of the MA thesis available at http://othes.univie.ac.at

About the Author

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