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Adequacy of Corporate Governance Mechanisms as Guide for Investors' Decision

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الملخص:

أصبحت آليات حوكمة الشركات (CG) موضوعًا مهمًا ويتزايد سنويًا في العالم. تناولت هذه الورقة مدى كفاية آليات حوكمة الشركات في قرارات المستثمرين في الشركات الليبية. وتضمنت الأبعاد في هذه الدراسة الالتزام بمبادئ حوكمة الشركات، وآليات التدقيق، وآليات الإفصاح والشفافية. فقد استخدم الاستبيان لجمع البيانات حول آليات حوكمة الشركات لعينة عشوائية مكونة من 100 مستثمر في السوق الليبي. وتوصلت الدراسة إلى عدم وجود علاقة ذات دلالة إحصائية بين آليات حوكمة الشركات في الشركات وقرارات المستثمرين. وأخيرا، لم توفر آليات حوكمة الشركات للمستثمرين أدلة كافية حول الاستثمار الجيد.

الكلمات المفتاحية: حوكمة الشركات، الاحتيال، الاستثمار.

Abstract

Corporate Governance (CG) mechanisms have become an important topic and are increasing yearly in the world. This paper examined the adequacy of CG mechanisms on investors' decisions in Libyan firms. The dimensions in this study included compliance with the principles of CG, audit mechanisms, and disclosure and transparency mechanisms. Using a questionnaire to collect data about CG mechanisms for a random sample of 100 investors in the Libyan market. The study found that there was no statistically significant relationship between the CG mechanisms in the firms and investors' decisions. Finally, the CG mechanisms did not provide the investors with enough clues about a good investment.

Keywords: Corporate Governance, Fraud, Investment.

1. INTRODUCTION

Corporate Governance (CG) is a widely used term across countries and firms, also the differences in CG standards create an opportunity for good practices to improve and achieve the targets of firms (Hussain & Loureiro, 2022).

CG involves a set of relationships between a firm's management, its board and its shareholders. Moreover, CG may refer to the systems, techniques, processes and structures that allow firms to manage and direct their goals toward the demands of shareholders (Tawfik, Alsmady, Rahman & Alsayegh, 2022).

The good practice of CG should provide appropriate incentives for the board and management to achieve goals in the best interests of the firm and its stockholders (Demise, 2006).

CG mechanisms are divided into three categories. The first one focuses on the role of internal mechanisms and incentives in controlling fraud. The second concentrates on the role of external mechanisms in checking fraud, such as an independent judiciary or watch bodies. The third one argues that fraud can be explained by more indirect factors, such as culture. (Tawfik, Alsmady, Rahman and Alsayegh, 2022; Zahoor, Lew, Arslan, Christofi and Tarba, 2023; Shahab, Gull, Rind, Sarang and Ahsan, 2022)

CG envisages the actual behavior of firms regarding performance, efficiency, growth, financial structure and relations with shareholders. On the other hand, there are concerns regarding the rules and regulations which are influencing the firm activity.

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Due to the number of fraud cases rising in big firms and insider trading cases, the trust of shareholders and investors has tremendously gone down. The public is wary of investing in the shares of various firms, and this led to relying on CG to stop this issue, which destroyed many countries. Therefore, the CG becomes more important to control the practices and responsibilities. In addition, it looks for the wrongdoings and makes strict control of that place to prevent the occurrence of such events.

CG is a critical factor that has significant effects on financial reporting quality and accuracy of the information in the reports. The ability of CG mechanisms is highly associated with the composition and characteristics of administrators and management to accomplish and control goals and practices in the firm and to detect and deter any deviations from goals.

CG is widely acknowledged as a major solution for all wrongdoings. CG is a network of principles and practices used to detect and constrain fraud. CG is necessary for every firm because it provides a governing body that ensures that the firm is running in the right direction and running well (Krechovska and Prohazkova, 2014).

The governance reports have been the subject of essential investors for the last decades. There are main research factors that have been concentrated in research to see what firms have reported; financial, social, and environmental disclosure practices can be linked to investor's decision or factors such as size, industry membership, risk, market reaction, external influences, firm reputation and country of origin or proximity to individual consumers. In Libya, the concern about CG has increased;

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therefore, it would test the effects on the investors' decisions and practices on the Libyan market.

2. LITERATURE REVIEW

2.1 Corporate Governance

In the CG literature, governance is conceptualized as an oversight function (Vintila & Gherghina, 2012). In addition, the CG is known as the system relating to the management and control of firms, also, a strong CG structure requires an effective board of directors and ownership structure (Krechovska and Prohazkova, 2014). In literature, it is theoretically proposed that strong CG is associated with an independent good functional board of directors, representing all shareholders with an optimum number of experienced and diversified members and an effective audit committee free of CEO influence (OECD, 2023).

However, the general purpose of governance is to ensure that the project will meet the goals and expectations determined by management and shareholders. These goals should be achieved by consistent and coherent implementation of governance roles and responsibilities by different management levels within the firm.

Its system specifies the distribution of rights and responsibilities among different management levels and employees. In addition, it provides the rules and procedures for making decisions. CG could also be considered as a coordination mechanism used as an approach to govern and organize the firm. (OECD, 2023)

A series of fraud events over the last three decades has been committed in different countries in the world, especially after the economic collapses and financial crises in a number of countries in East Asia, Latin America, North America and Russia. These events were the reason for the creation of what is called CG in the business sector in the world. According to OECD (2004), the importance of CG became clear in 2002 as a series of accounting and financial collapses for several prominent firms in the USA, such as Enron, WorldCom, Adelphia Communications, Global Crossing… etc. Many economists, analysts and experts have argued the importance and extent of the influence of the concept of CG in many aspects of economic, legal and social efforts to the benefit of individuals, institutions, and societies as a whole in developed and developing countries alike.

2.2 Definition of Corporate Governance

According to Cheffins (1999), there is no universally accepted definition of CG agreed upon between all economists, lawyers, and analysts, and there is no common definition of this concept. This may be due to overlaps in many of the organizational matters and economic, financial and social conditions of the firms, which affect the community and economy as a whole. However, there are several definitions of firm governance; for example, OECD (2004) defined CG as:

"One key element in improving economic efficiency and growth, as well as enhancing investor confidence, and involves a set of relationship between a firm's management, its board, its shareholders, and other stakeholders. Also, corporate governance provides the structure through which the objectives of a firm are set, and the means of attaining those objectives and performance are determined".

Monks and Minow (2003) believed THAT good CG mechanisms can solve the Agency Problem. Recently, the issue of CG has become very significant in achieving both economic development and the prudent legal and social welfare of economies and societies. Regarding the economic level, the increased importance of CG rules can be referred to as the following:

1. To ensure an adequate amount of reassurance to investors and shareholders to achieve a suitable return for their investments.
2. To maximize the value of the firm, maximize shareholder value, and strengthen the competitiveness of firms in the international capital markets.
3. To ensure efficient implementation of the privatization programs and good guidance procedures to make optimal use of them, to prevent any of the corruption cases that may be linked to this.
4. To avoid slipping into financial and accounting problems, including working to strengthen and stabilize the activity of firms operating the economy, protect the local markets and global markets, and assist in achieving development and economic stability.
5. To provide funding sources for local or global firms, especially in light of the increasing speed of the movement of capital flows.

It confirmed the importance of CG to achieve economic development and to avoid the consequences of financial crises, through the consolidation of a number of performance standards. These standards include work to strengthen the economic fundamentals and market manipulation and detection of cases of corruption and mismanagement. Moreover, control on applying the general accounting acceptance principles (GAAP) and general auditing acceptance standards (GAAS). (Monks and Minow, 2003)

2.3 Corruption

Corruption is a significant threat that harms the economy, development and social stability of the country. In addition, corruption is widely understood as ‘‘the acts in which the power of the higher position is used for personal gain in a manner that contravenes the rules of the law (Nguyen and Dijk, 2012). "Corruption often results from patronage and is associated with bribery" (Business Dictionary, 2012). However, there are several definitions of corruption, for example,

Lal Balkaran defined corruption (1999) as:

“Corruption is a term with many meanings, but generally, it entails misusing one's office for a private gain or unofficial end. It involves both monetary and non-monetary benefits. Bribery, extortion, influence peddling, nepotism, scams, fraud, ‘grease money’, and opportunism readily spring to mind”.

International Business Leaders Forum and Transparency International (2005) defined corruption as: “*the abuse of entrusted power for private gain”.*

This definition is reflected in the reported measures of the perceptions of national corruption levels (Transparency International, 2010). Such public corruption may have a corrosive effect on the integrity of a nation's entire system (Voyer & Beamish, 2004), it may reduce operational efficiency, distort public policy, slow the dissemination of information, negatively impact income distribution, and increase the poverty of an entire nation (Chen, Ding, & Kim, 2010).

3. PRACTICAL STUDIES

Arcot, Bruno and Faure-Grimaud (2010) examined the effectiveness of CG in the UK by using a unique database of 245 non-financial firms for the period of 1998–2004. It was discovered that there was compliance with the combined code for CG due to some firms following the letter of the regulatory requirements without making a serious commitment to firm governance; they depart from best practice and provide an explanation which is totally uninformative.

Vintila and Gherghina (2012) examined the relationship between CG ratings and firm performance, including both a global measure of CG and four sub-indices corresponding to Audit, Board Structure, Shareholder Rights, and Compensation provided by Institutional Shareholder Services (ISS). The data was collected from a random sample of 155 U.S. firms listed at the New York Stock Exchange, NASDAQ and NYSE Amex Equities, belonging to twenty industries in 2011, using the cross-sectional multiple linear regression model to emphasize a negative relationship between CG global rating and firm performance. Thus, a negative relationship between CG and firm performance was identified by five ratios.

In 2013, Karaibrahimoğlu investigated the association between CG and external auditors. The author chose the firms that worked in the Istanbul Stock Exchange (ISE) between the years 2005-2009. The sample was 805 firms. Overall, the author found that firms' auditor choice in terms of Big-4 and audit firm industry specialization is affected by the firm-level CG mechanisms of firms, particularly the board of directors' composition and ownership structure.

Handley and Mohamed (2014) conducted a study that examined the potential means available to firm managers, auditors and regulators for preventing, detecting and reacting to financial statement fraud in Malaysia. The research was conducted by means of interviews with firm managers, auditors and regulators. It was found that management integrity and the development of internal systems to prevent fraudulent reporting were very high. However, the probability of financial statement fraud is reduced by regulators. Regulations that were set to deter and react to cases where such frauds are detected helped to reduce the number of cases.

Tawfik, Alsmady, Rahman, and Alsayegh (2022) investigated whether corporate governance mechanisms affect the royal family ownership firm performance relationship. The data sample of the study included 266 company-year observations over the period of 2009-2017. The study showed that firm performance significantly deteriorates with institutional ownership, chief executive officer duality and local auditors. Furthermore, the results revealed that royal ownership has a significant positive effect on firm performance. Further analysis found that the corporations in the Gulf Cooperation Council (GCC) region establish the best governance mechanisms to enhance firm performance.

Liu, Tang and Zhang (2023) examined corporate governance by mitigating managers' moral hazard problems and affecting firms' operational efficiency, significantly influencing firms' allocation of funds between investing in internal projects and financial investments. It created a model to test how corporate governance influences firms' financialization through increasing managerial efforts and suppressing extravagant consumption and tunnelling behavior. The data of the study included China's non-financial firms' financialization, including investing in entrusted loans and wealth management products (WMPs). In conclusion, the study showed that enhancing corporate governance could suppress non-financial firms' financialization.

Feng, Pan, Ho and Liu (2023) studied the impact of minority shareholders' participation in governance on corporate investment efficiency. The study examined information from companies listed on the Shenzhen Stock Exchange between 2011 and 2017 to examine the implications of online voting regulations in China. Employing a quasi-natural experiment with the difference-in-differences model, the results revealed that online voting by minority investors increases corporate investment efficiency. Furthermore, the results showed that the impact of minority investors' online voting is more evident in firms with less internal governance and weaker external monitoring mechanisms. Additionally, minority investor participation in governance increases corporate investment efficiency by increasing information transparency and the quality of internal control.

Yi (2023) examined the impact of cash flow on investment spending under the scenarios of underinvestment and overinvestment and the moderating effect of corporate governance and information disclosure on the sensitivity of both. This study was made on listed companies in the manufacturing sector from 2013 to 2020 in China. Finally, it resulted that companies were highly sensitive to cash flow under financing constraints and overinvestment due to agency costs; in the case of underinvestment, improving corporate governance significantly reduces investment-cash flow sensitivity.

4. RESEARCH RATIONALES & MOTIVATIONS

The topic of CG has gained a great deal of attention across the world empirically and academically. In addition, corruption is the most important phenomenon, which opened a lot of discussions calling for the establishment of strict CG mechanisms to eliminate this phenomenon.

The attention has increased the importance of CG in the world, especially after the recession in many regions. The CG mechanisms for all wrongdoings can be explained by three types of determinants. The first focuses on the role of internal mechanisms and incentives in controlling fraud. The second one concentrates on the role of external mechanisms in checking fraud, such as an independent judiciary or watch bodies, while the third one argues that fraud can be explained by more indirect factors, such as culture.

However, this study will focus on the effect of these mechanisms on the investors' decisions. Only a few studies touch upon the relationship between CG mechanisms and investors. None of these studies answers the question of how CG mechanisms may help to increase the trust of investors and encourage them to invest in firms that have a good system of CG.

Despite the efforts to face corruption, CG has been taught in Libyan universities and practiced in Libyan firms. Therefore, the main question of this research is, **"Are CG mechanisms adequate for investors to invest in the Libyan Market?"**

5. IMPORTANCE OF THE RESEARCH

The CG is a crucial requirement to direct, control, and establish stability in the public and private sectors. When the disclosure and transparency level is increased, the investors would be affected by the firm's position. Studying the CG will help to identify what various investors perceive as the importance of CG mechanisms and their impact on the firm. Therefore, it is expected that the research will contribute to the knowledge of several points regarding CG.

6. RESEARCH METHODOLOGY & HYPOTHESIS

To achieve the objectives of this study, the data was collected based on the questionnaire. The questionnaire was designed to test the exitance of the mechanisms that affect their investing decision. In order to maximize the accuracy of data, the questionnaire was distributed to businessmen and businesswomen from the Libyan markets. CG external and internal mechanisms were chosen to be tested in this study because the other indirect factors are uncontrollable to be measured.

The questionnaire sought to cover all aspects of external and internal CG mechanisms; hence, conclusions would be drawn only regarding the specific questions explicitly addressed by the questionnaire instrument. It was intended to serve as a baseline for future comparisons of trends over time for a select number of issues covered here. In order to investigate the relationship between external and internal CG mechanisms and investors' decisions, a random sample of 100 investors was used in 2023. Moreover, the data were processed using the well-known statistical analysis program SPSS (IBM 25). Here is the main hypothesis:

H0: There is no statistically adequate effect of CG mechanisms on the investors' decisions in the Libyan Market.

H1: There is a statistically adequate effect of CG mechanisms on the investors' decisions in the Libyan Market.

7. RESULTS AND ANALYSIS

This section discusses the major findings and ties them with the research's main question. This research addresses the following points: compliance with the principles of CG, audit mechanisms, and disclosure and transparency mechanisms. The following parts discuss and summarize the major findings of the study in order to determine the level of efficiency of CG mechanisms. This table shows the personal information about the participants.

Table (1) General Information about the participants

Questions	Number of Participants	Percentage
Gender:		
Male	71	71%
Female	29	29%
Age:		
20 - 30 years	19	19%
31 - 40 years	71	71%
41 - 50 years	10	10%
Over 51 years	-	-
Years of Experience		
1-5 Years	1	1%
6-10 Years	50	50%
11-15 Year	39	39%
16-20 Years	10	10%
More 21 Years	-	-
Education:		
None Professional	-	-
University	99	99%
Post-graduate studies	1	1%

More than half of the participants were males, and 90% of the participants were less than 40 years old. There was one person who had a graduate level, but the rest held university certificates. 51% of participants experienced less than ten years, but the rest had more than 15 years.

7.1 Compliance with the Principles of Corporate Governance

Table (2) shows the responses of participants about the effect of the compliance of the principles of CG in Libyan firms on their investing decisions.

Table (2) Compliance with the Principles of Corporate Governance

N	Question	Accept	Don't Accept	SD
5	A firm that adopted the principles of the CG.	43%	57%	0.498
6	A firm that has its own policy of CG.	9%	91%	0.288
7	A firm that announces within its financial reports the compliance with the principles of CG.	64%	36%	0.482
8	A firm that considered the interests of shareholders in accordance with the principles of CG.	52%	48%	0.502
9	The frequency of performance evaluation affects your investment decision	47%	53%	0.502
10	The Criteria for Performance affect your investment decision	26%	74%	0.441
11	Reward and sanction systems in the firm affect your investment decision	26%	74%	0.441
Average		**38%**	**62%**	**0.451**

As in Table 2, 62% was the average percentage of participants who accepted that compliance with the principles of CG would not affect their decision in the Libyan environment but 38% accepted that. While there was a high percentage of participants who accepted the effectiveness of the announcements in the financial reports about compliance, also when considering the interest of the shareholders according to the principles of CG.

There is a very low percentage of participants who accepted the effect of the adoption of the principles on the investment decision. In addition, there is a very low percentage of having its own policy of CG. Moreover, the participants did not accept the effect of the frequency of the evaluation and the quality of criteria for performance on the investing decision. In addition, the participants did not accept the effect of the reward and punishment system on the investing decision. These results indicated that there is no statistically significant relationship between compliance with the principles of CG and the investors' decisions.

7.2 Audit Mechanisms

Table (3) shows the responses of participants about the effect of the audit mechanisms of CG in Libyan firms on their investing decisions.

Table (3) Audit Mechanisms

N	Question	Accept	Don't Accept	SD
12	A good external auditor of the firm affects your investment decision	14%	86%	0.349
13	The related external auditor of the firm affects your investment decision	14%	86%	0.349
14	The amount of money that is paid to the external auditor affects your investment decision	26%	74%	0.441
15	The external auditor's report affects your investment decision	59%	41%	0.494
16	The internal auditing system affects your investment decision	59%	41%	0.494
Average		**34%**	**66%**	**0.425**

In Table 3, the majority of the participants (66%) did not accept the effectiveness of mechanisms in their decision. The average percentage shows that 34% of participants accepted the mechanisms of auditing their investments. In contrast, there was a high percentage of acceptance of the external auditor's report and the internal auditing system on the investment decision. Therefore, there is no statistically insignificant relation between the audit mechanisms of CG and the investing decision.

7.3 Disclosure and Transparency Mechanisms

Table (4) shows the responses of participants about the effect of the disclosure and transparency mechanisms of CG in Libyan firms on their investing decisions.

Table (4) Disclosure and Transparency Mechanisms

N	Question	Accept	Don't Accept	SD
17	Availability of all reports to the shareholders affects your investment decision	7%	93%	0.256
18	The meetings in the firm with investors in the last years affect your investment decision	66%	34%	0.476
19	All members of the executive board and management affect your investment decision	56%	44%	0.499
20	The Criteria for promotion and salary for the executive board and management affect your investment decision	14%	86%	0.349
Average		36%	64%	0.395

In Table 4, the average percentage shows that 36% of participants accepted the disclosure and transparency mechanisms of CG in their decision. Many of the participants (64%) did not accept the disclosure and transparency mechanisms of CG in their decisions. In contrast, there was a high percentage of acceptance of the annual meeting between the management and the investors. Moreover, the member of the executive board was accepted to be effective in the investment decision. Finally, there is no statistically insignificant relation between the disclosure and transparency mechanisms of CG on the investing decision.

8. CONCLUSION

Weak CG mechanisms damage the reputation of the firms and destroy the business foundation in the countries. This paper shows how the quality of CG in Libya affects investors' behaviors and the consequence of CG application on future investments and shareholder values. This study contributes to the literature by demonstrating the significant influence of investor decisions on CG practices and mechanisms. Prior studies examined the CG practice on the performance of the firms and the incomes of the firms.

The questionnaire of this study sought to explore CG practices in Libyan firms and their impact on investors' decisions. To investigate whether these firms that have used the CG mechanisms could get more funds easily from the investors.

The questionnaire results provided clear evidence that there is no relation between the mechanisms of CG in the firms and investors' decisions by considering all main points of internal and external mechanisms of CG. All the CG techniques of making the firm a better place to invest, while the investment decision in the Libyan market is made based on the personality of management and the staff in the firm, the investors used their exception of future performance of the firm to decide the investment.

In conclusion, the null hypothesis failed to be rejected. This fact would signify that when the mechanisms of CG are used, the power of increasing funds from the Libyan market is worthless. This situation is unfavorable to the CG literature. Therefore, CG mechanisms are not the best benchmark that can provide investors with information about the accuracy and safe investment.

Finally, this study provides an analysis that CG should be utilized to guide investors about good investment and to mitigate managers' moral hazard. Therefore, future research should consider all the mechanisms and components of CG to achieve more robust information.

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