

Application of New Institutional Economics in Corporate Governance Optimization

Junzhe Zhao

Linyi No.1 High School Shandong Province, Linyi, China

Email: zhaokuhe200710@outlook.com

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Abstract

New Institutional Economics provides a unique analytical perspective for understanding and improving corporate governance. This study explores the application of New Institutional Economics theory in corporate governance optimization. The research first reviews the core concepts of New Institutional Economics, including transaction costs, property rights, and contract theory. Through comparative analysis, the study points out the advantages of New Institutional Economics over neoclassical economics in explaining corporate governance issues. The research focuses on how transaction cost theory guides the design of internal governance structures, how property rights theory influences the arrangement of ownership structures, and how incomplete contract theory explains the role of the board of directors. Through analysis, the study demonstrates the practice of corporate governance innovation from the perspective of New Institutional Economics. The research also discusses the potential application of New Institutional Economics in addressing emerging governance issues, such as stakeholder governance and ESG governance. However, the study also points out the limitations of New Institutional Economics in quantitative analysis and prediction. To address these limitations, the study proposes an integrated research framework combining empirical methods and behavioral economics. This research provides new insights for the innovative development of corporate governance theory and practice, helping enterprises achieve effective governance in complex institutional environments.

Keywords

New Institutional Economics, Corporate Governance, Transaction Costs, Property Rights Theory, Contract Theory

1. Introduction

Corporate governance, as the core of modern enterprise systems, has become

increasingly important in the context of an increasingly complex global economic environment. With intensified market competition, accelerated technological innovation, and diversified stakeholder demands, traditional corporate governance theories and practices face unprecedented challenges. Against this background, New Institutional Economics provides a unique analytical perspective and theoretical tools for understanding and optimizing corporate governance.

A significant body of literature has explored the application of New Institutional Economics in corporate governance. For instance, [Williamson \(1985\)](#) established the fundamental framework for analyzing corporate governance through transaction cost economics. [North \(1990\)](#) contributed to understanding how institutional frameworks shape corporate governance practices. Recent studies by [La Porta et al. \(2018\)](#) have demonstrated the crucial role of legal institutions in determining corporate governance outcomes across different countries.

New Institutional Economics emphasizes the key role of institutions in economic activities, focusing on the impact of transaction costs, property rights arrangements, and contract design on the behavior of economic agents, which highly aligns with the essential issues of corporate governance. In recent years, academia has increasingly used the theoretical framework of New Institutional Economics to analyze corporate governance issues and explore how to design more effective governance mechanisms ([Aguilera et al., 2021](#)). The focus on transaction costs in New Institutional Economics provides new ideas for understanding the design of internal governance structures. Property rights theory lays the theoretical foundation for analyzing the impact of ownership structure on corporate governance. Incomplete contract theory helps us understand more deeply the role and functions of the board of directors. Moreover, the perspective of New Institutional Economics also provides unique insights for solving emerging corporate governance issues, such as stakeholder governance and ESG governance. However, the application of New Institutional Economics in corporate governance research still faces some challenges, such as how to translate its theoretical insights into operable governance practices, and how to combine it with other research methods to improve explanatory power and predictive ability. This study aims to systematically review the application of New Institutional Economics in corporate governance optimization, analyze its advantages and limitations, and explore future research directions. Through this research, we hope to provide new ideas for the development of corporate governance theory and innovation in practice, helping enterprises achieve more effective governance in complex and changing institutional environments.

The remainder of this paper is organized as follows. Section 2 discusses the core theories of New Institutional Economics and their application in corporate governance. Section 3 explores corporate governance innovation from the perspective of New Institutional Economics. Section 4 examines the limitations of New Institutional Economics in corporate governance research and discusses future prospects. Finally, Section 5 concludes the paper.

2. Core Theories of New Institutional Economics and Their Application in Corporate Governance

2.1. Transaction Cost Theory and Internal Governance Structure

Transaction cost theory is one of the core pillars of New Institutional Economics, first proposed by Coase and further developed by Williamson. This theory posits that the organization of economic activities depends on the level of transaction costs. In the field of corporate governance, transaction cost theory provides an important perspective for understanding and designing internal governance structures. For example, [Williamson's \(1985\)](#) seminal work demonstrates how asset specificity, uncertainty, and frequency of transactions influence the choice of governance structures. Recent empirical studies by [Geyskens et al. \(2006\)](#) provide strong evidence that these factors significantly affect make-or-buy decisions and vertical integration strategies. Companies can be viewed as a collection of contracts, and one of the goals of corporate governance is to reduce the execution costs of these contracts ([Williamson, 1985](#)). According to transaction cost theory, the design of internal governance structures should consider the transaction costs under different governance mechanisms. For example, when deciding whether to outsource a certain business, companies need to weigh the market transaction costs against internal management costs. When a transaction has high specificity, high uncertainty, and high frequency, internalization may be more efficient. This theory has guided company decisions in vertical integration, diversification, and organizational structure design. In terms of board structure design, transaction cost theory emphasizes that the proportion and professional background of independent directors should be determined based on the specific situations faced by the company, to reduce monitoring costs and decision-making costs. Transaction cost theory also provides new ideas for understanding and designing incentive mechanisms, such as using equity incentives to reduce agency costs. In recent years, researchers have begun to apply transaction cost theory to emerging corporate governance issues, such as governance structure optimization in the context of digital transformation ([Tian et al., 2021](#)). However, the application of transaction cost theory also faces some challenges, such as the difficulty in accurately quantifying transaction costs, and how to balance short-term cost control with long-term value creation.

2.2. Property Rights Theory and Ownership Structure Arrangement

Property rights theory is another important component of New Institutional Economics, emphasizing the impact of property rights arrangements on economic efficiency. In the field of corporate governance, property rights theory provides a theoretical basis for understanding the role of ownership structure. According to property rights theory, clear property rights help incentivize and constrain the behavior of economic agents, thereby improving resource allocation efficiency. In corporate governance, ownership structure directly affects the distribution of

control rights and incentive mechanisms in a company. Property rights theory argues that factors such as ownership concentration, shareholder type, and ownership nature all have important impacts on corporate governance effectiveness. For example, a highly concentrated ownership structure may lead to conflicts of interest between controlling shareholders and minority shareholders, while a dispersed ownership structure may exacerbate agency problems between management and shareholders. Property rights theory also provides an explanatory framework for understanding the differences in governance efficiency between state-owned enterprises and private enterprises. Research shows that ownership nature affects enterprises' innovation input, risk-taking, and social responsibility behavior (Boubakri et al., 2020). In addition, property rights theory also provides theoretical support for understanding emerging forms of corporate governance, such as mixed ownership reform. In recent years, with the development of the digital economy, property rights theory has also shown application potential in explaining new issues such as data ownership and platform governance (Kouroumpis et al., 2020). However, the application of property rights theory also faces some challenges, such as how to seek a balance between protecting investor rights and maintaining enterprise operational autonomy, and how to design property rights arrangements adapted to different institutional environments.

2.3. Incomplete Contract Theory and the Role of the Board of Directors

Incomplete contract theory is an important branch of New Institutional Economics, emphasizing that in complex and uncertain environments, it is impossible to stipulate in advance contractual arrangements for all possible situations. This theory provides a new perspective for understanding several key issues in corporate governance, especially in explaining the role and functions of the board of directors. According to incomplete contract theory, a company can be viewed as a network of stakeholders connected by incomplete contracts. Within this framework, the main function of the board of directors is to coordinate between shareholders and management, dealing with situations not explicitly stipulated in contracts. This theory emphasizes the importance of the board of directors in strategic decision-making, supervision of management, and resource acquisition. Incomplete contract theory also provides guidance for understanding the composition and operating mechanisms of the board of directors. For example, the introduction of independent directors can be seen as a mechanism to address contractual incompleteness, bringing in external professionals to compensate for internal decision-making deficiencies. Furthermore, incomplete contract theory provides a theoretical basis for understanding how the board of directors balances the demands of different stakeholders, which is particularly important in dealing with issues such as corporate social responsibility and sustainable development (Ferreira et al., 2020). In recent years, as companies face increasingly complex environments, incomplete contract theory has shown new application value in explaining how

boards of directors respond to sudden crises, technological changes, and other challenges. However, incomplete contract theory also faces some challenges in practical application, such as how to design incentive mechanisms to ensure board members effectively perform their duties, and how to adjust the role and functions of the board of directors in different institutional environments.

As shown in **Figure 1**, incomplete contract theory provides a theoretical framework for understanding the core role of the board of directors in corporate governance. The board of directors, as the hub connecting shareholders, management, and other stakeholders, plays a key role in addressing the challenges brought by incomplete contracts. The figure shows the three main functions of the board of directors: strategic decision-making, supervising management, and resource acquisition. These functions all stem from incomplete contract theory's interpretation of the board's role, emphasizing the importance of the board in dealing with situations not explicitly stipulated in contracts. The board of directors fills the governance gaps that may be caused by incomplete contracts by balancing the demands of different stakeholders, thereby improving the efficiency of corporate governance.

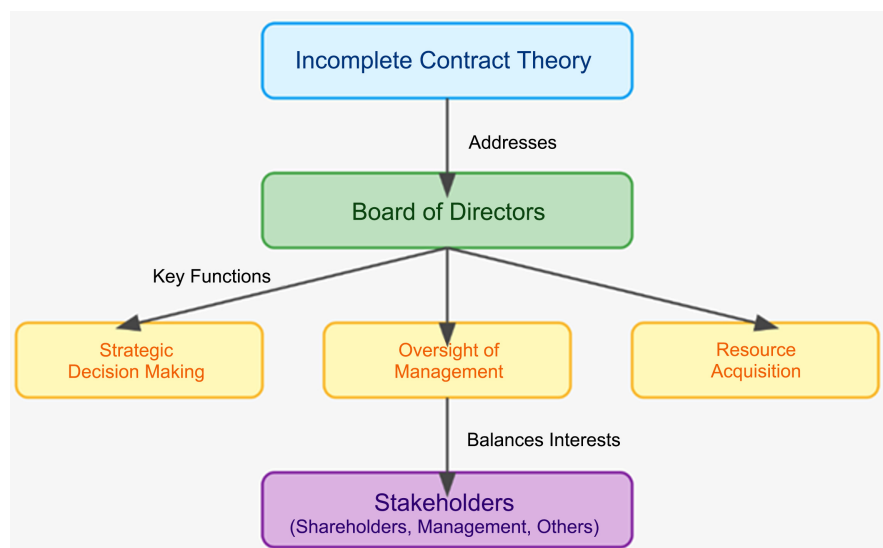


Figure 1. Incomplete contract theory and the role of board of directors.

3. Corporate Governance Innovation from the Perspective of New Institutional Economics

3.1. Institutional Design of Stakeholder Governance

New Institutional Economics provides a unique perspective for understanding and practicing stakeholder governance. Stakeholder governance emphasizes that companies should not only be accountable to shareholders but also balance the demands of various stakeholders. From the perspective of New Institutional Economics, this governance model can be understood as a more complex institutional arrangement aimed at reducing transaction costs between the company and

various stakeholders and creating long-term value. The transaction cost theory of New Institutional Economics points out that effective stakeholder governance can reduce friction between the company and groups such as employees, suppliers, and customers, thereby improving operational efficiency. Property rights theory emphasizes that by granting certain decision-making rights and income rights to different stakeholders, they can be incentivized to create value for the company. In practice, the institutional design of stakeholder governance may include: establishing multi-party interest coordination mechanisms, such as stakeholder advisory committees; designing inclusive decision-making processes to ensure major decisions consider the interests of all parties; establishing information disclosure systems for various stakeholders to improve transparency; designing diversified performance evaluation systems that incorporate social and environmental performance into assessments (Kurucz et al., 2020). However, stakeholder governance also faces challenges such as how to balance the demands of different groups and how to quantify non-financial goals. New Institutional Economics reminds us that when designing such governance mechanisms, we need to consider differences in institutional environments and the unintended consequences that institutional changes may bring. Future research can further explore how to design effective stakeholder governance mechanisms in different institutional backgrounds and how to evaluate the long-term economic and social effects of this governance model.

3.2. Construction of Institutional Framework for ESG Governance

Environment, Social, and Governance (ESG) has become an important dimension of modern corporate governance. New Institutional Economics provides strong theoretical support for constructing the institutional framework of ESG governance. From the perspective of transaction cost theory, effective ESG governance can reduce friction costs between companies and external stakeholders, improving long-term operational efficiency. Property rights theory provides new ideas for understanding how ESG objectives can be coordinated with traditional shareholder value maximization goals. Incomplete contract theory emphasizes the need for flexible governance mechanisms to address uncertainties in complex ESG issues. In practice, the institutional framework of ESG governance may include: establishing ESG committees to strengthen the board's supervisory function on ESG matters; designing executive compensation incentive mechanisms related to ESG; improving ESG information disclosure systems to enhance transparency and comparability; establishing ESG risk management systems to incorporate ESG risks into the enterprise's comprehensive risk management framework (Eccles et al., 2020). The perspective of New Institutional Economics also reminds us that the effectiveness of ESG governance largely depends on the external institutional environment, such as government regulations, market mechanisms, and social norms. Therefore, when constructing the ESG governance framework, it is necessary to consider the impact of these external factors. Future research can further

explore how to design ESG governance mechanisms adapted to different institutional environments and how to evaluate the impact of ESG governance on long-term value creation of companies. In addition, with technological advancements, how to leverage new technologies such as big data and artificial intelligence to optimize ESG governance is also a direction worth attention.

3.3. Corporate Governance Innovation in the Digital Era

Digital transformation is profoundly changing the operational models and governance environment of enterprises, and New Institutional Economics provides a useful theoretical perspective for understanding and responding to this transformation. From the perspective of transaction cost theory, the application of digital technology can significantly reduce the costs of information acquisition and processing, thereby changing the optimal governance structure and mechanisms. For example, the application of blockchain technology may reduce the costs of shareholder voting and corporate information disclosure, promoting wider shareholder participation. Property rights theory provides an analytical framework for understanding new issues such as data ownership and digital asset management. In the digital economy, data becomes a key production factor, and how to define and protect data property rights becomes a new topic in corporate governance. Incomplete contract theory reminds us that in the rapidly changing digital environment, governance mechanisms need to have sufficient flexibility to respond to unforeseen situations. In practice, corporate governance innovation in the digital era may include: using artificial intelligence to assist board decision-making; establishing real-time digital risk monitoring systems; designing dynamic compensation incentive mechanisms based on big data analysis; developing open innovation governance models based on platforms, etc. (Fenwick et al., 2020). However, digitalization also brings new governance challenges, such as algorithmic bias, data privacy protection, and cybersecurity. New Institutional Economics suggests that we should pay attention to the institutional risks that these new technology applications may bring and design corresponding governance mechanisms to address them. Future research can further explore how digitalization reshapes company boundaries and governance structures, and how to balance efficiency and fairness, innovation and risk control in the digital environment. To better understand how digital transformation impacts corporate governance structures, we first need to examine the key technological drivers and their implications for governance mechanisms. **Figure 2** illustrates the relationship between digital technologies and corporate governance innovation.

As shown in **Figure 2**, digital transformation is profoundly affecting various aspects of corporate governance. New technologies such as artificial intelligence, blockchain, and big data analysis are reshaping key governance areas such as decision-making, risk management, information disclosure, and stakeholder engagement. At the same time, this transformation also brings new challenges, such as algorithmic bias, data privacy, and cybersecurity issues. The perspective of New

Institutional Economics helps us understand these changes and design innovative governance mechanisms adapted to the digital era.

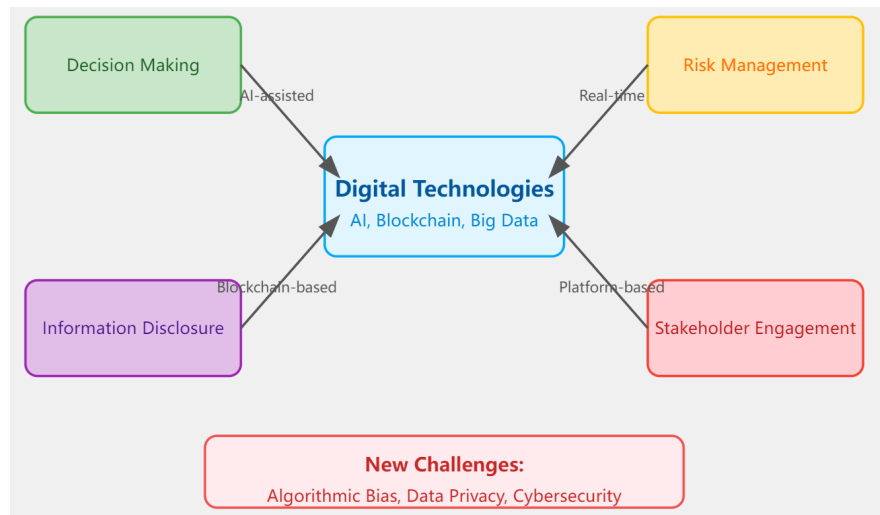


Figure 2. Digital transformation and corporate governance innovation.

4. Limitations of New Institutional Economics in Corporate Governance Research and Future Prospects

4.1. Challenges in Quantitative Analysis and Prediction

Although New Institutional Economics provides rich theoretical perspectives for corporate governance research, it still faces some challenges in quantitative analysis and prediction. Firstly, the core concepts of New Institutional Economics, such as transaction costs and institutional environment, are often difficult to accurately quantify. This makes empirical research based on New Institutional Economics operationally challenging. For example, although transaction costs theoretically have a significant impact on the choice of governance structures, how to precisely measure transaction costs under different governance mechanisms remains a challenge in actual research (Williamson, 2010). Secondly, New Institutional Economics emphasizes the path dependence and historical specificity of institutional change, which poses challenges for predictive analysis based on historical data. The complexity and dynamics of the institutional environment mean that past experiences may not be sufficient to accurately predict future governance trends. Moreover, New Institutional Economics theory emphasizes the importance of informal institutional constraints (such as culture, customs, etc.), but these factors are usually difficult to quantify and model. This limits the application of New Institutional Economics in cross-cultural corporate governance research (Aguilera & Grøgaard, 2022). Facing these challenges, future research can consider the following directions: developing more refined institutional measurement indicators, combining big data and machine learning technologies to capture complex institutional environments; designing long-term tracking studies to better understand the impact of institutional changes on corporate governance;

combining qualitative and quantitative methods to deeply explore the influence mechanisms of informal institutions on corporate governance.

4.2. Integration with Other Theoretical Perspectives

Although New Institutional Economics provides unique insights for corporate governance research, a single theoretical perspective is difficult to comprehensively explain the complexity of corporate governance. Therefore, integrating New Institutional Economics with other theoretical perspectives to construct a more comprehensive analytical framework becomes an important direction for future research. New Institutional Economics can be deeply integrated with agency theory. Agency theory focuses on information asymmetry and incentive problems in principal-agent relationships, while New Institutional Economics emphasizes the impact of the institutional environment on these relationships. Combining the two can better understand the design of corporate governance mechanisms in different institutional backgrounds (Aguilera et al., 2021). New Institutional Economics can be combined with resource dependence theory. Resource dependence theory focuses on how companies acquire key resources through external connections, while New Institutional Economics emphasizes how the institutional environment shapes these external relationships. Combining the two can more comprehensively analyze how the resource acquisition function of the board of directors is influenced by the institutional environment. Moreover, New Institutional Economics can engage in dialogue with behavioral economics. Behavioral economics focuses on cognitive biases and bounded rationality in individual decision-making, while New Institutional Economics emphasizes how institutions influence individual behavior. Combining the two can more deeply explore how the institutional environment affects the decision-making behavior of managers and directors (Bebchuk & Tallarita, 2020). New Institutional Economics can also be integrated with organizational ecology theory to explore how the institutional environment influences the evolution and diffusion of corporate governance models. Future research can further explore the possibilities of these theoretical integrations, constructing multi-level, multi-dimensional corporate governance analysis frameworks. This integration not only helps overcome the limitations of single theoretical perspectives but may also generate new theoretical insights, promoting innovative development in corporate governance research.

4.3. Practical Application and Policy Implications

The application of New Institutional Economics in corporate governance research not only has theoretical significance but also important implications for practice and policy-making. However, how to translate theoretical insights into operable governance practices and policy recommendations still faces challenges. Firstly, New Institutional Economics emphasizes the importance of the institutional environment, which means that effective corporate governance practices may vary by country and industry. How to design governance mechanisms adapted to

different institutional backgrounds becomes a key issue in practical application. Secondly, New Institutional Economics emphasizes the gradualism and path dependence of institutional change, which suggests that we need to consider historical factors and transition costs when implementing governance reforms. How to promote governance innovation while maintaining institutional continuity is a challenge faced by policymakers. Moreover, corporate governance from the perspective of New Institutional Economics involves multiple stakeholders, and how to balance the demands of different groups in policy design is also a complex issue. Facing these challenges, future research can consider the following directions: conducting more cross-country comparative studies to explore differences in corporate governance best practices under different institutional environments; conducting long-term tracking studies to analyze the implementation process and effects of governance reforms; strengthening industry-academia-research cooperation to promote the connection between theoretical research and practical application. In addition, attention needs to be paid to emerging fields, such as governance issues in the digital economy and platform enterprises, to provide theoretical guidance and policy recommendations for the governance of these new organizational forms.

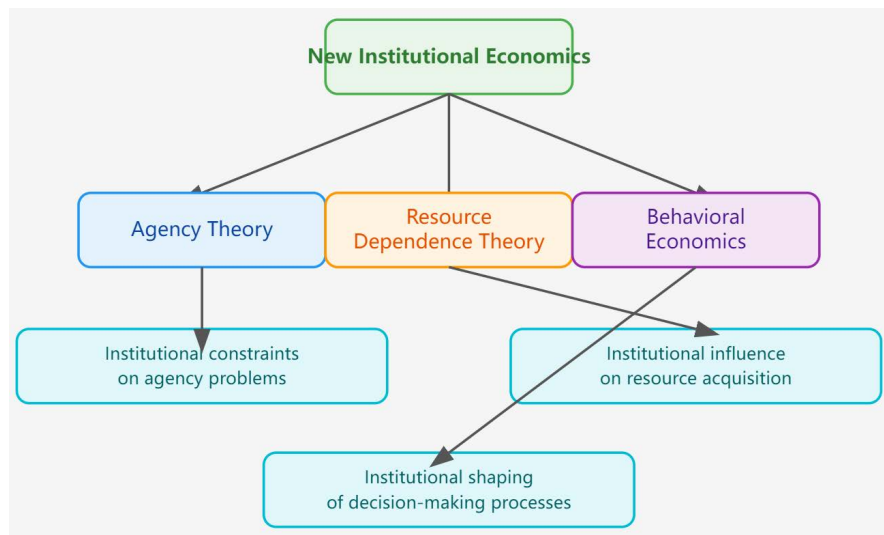


Figure 3. Integration of new institutional economics with other theoretical perspectives in corporate governance research.

As shown in **Figure 3**, New Institutional Economics can be integrated with multiple theoretical perspectives to form a more comprehensive corporate governance analysis framework. This integration can not only overcome the limitations of single theories but also generate new research insights. For example, the combination of New Institutional Economics and agency theory can help us understand how the institutional environment affects the nature and resolution of agency problems; integration with resource dependence theory helps analyze how institutional factors influence companies' resource acquisition strategies. This

multi-theory integrated research direction is expected to promote innovation in corporate governance research.

5. Conclusion

New Institutional Economics provides a unique and insightful analytical perspective for corporate governance research, deepening our understanding of the complexity of corporate governance. By emphasizing the importance of the institutional environment, New Institutional Economics helps us better explain the diversity and dynamic evolution of corporate governance practices. This study systematically reviews the application of core theories of New Institutional Economics in corporate governance optimization, including the guidance of transaction cost theory on internal governance structure design, the impact of property rights theory on ownership structure arrangements, and the explanation of incomplete contract theory on the role of the board of directors. The study also explores corporate governance innovation from the perspective of New Institutional Economics, especially its application potential in emerging fields such as stakeholder governance, ESG governance, and digital governance. However, the application of New Institutional Economics in corporate governance research also faces challenges in quantitative analysis and prediction. In response to these limitations, the study proposes future research directions such as integration with other theoretical perspectives and strengthening empirical research. Looking ahead, New Institutional Economics still has broad application space in corporate governance research, especially in understanding and addressing new governance challenges brought by globalization and digitalization. Through continuous innovation and interdisciplinary integration, New Institutional Economics is expected to make greater contributions to the development of corporate governance theory and the optimization of practice.

Conflicts of Interest

The authors declare no conflicts of interest regarding the publication of this paper.

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