SESSION 3: ACCOUNTING, AUDITING, FIRM PERFORMANCE

DOES CORPORATE GOVERNANCE INFLUENCE FIRM PERFORMANCE?

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Abstract

Corporate governance (CG) practices have evolved significantly in different economies, with the aim of protecting companies' stakeholders. In the last decades, it has been recognized by investors, regulators, and authorities in the capital markets that it has a vital role in the success of firms, namely impacting on firm performance. Financial scandals, such as those involving Banco Espírito Santo, Enron, and Lehman Brothers, further highlighted its importance. CG definitions typically emphasize protecting stakeholder and shareholder interests. Effective CG reduces risk, enhances capital market access, increases foreign investment, and maximizes firm value (Worokinasih & Zaini, 2020). However, previous studies find inconsistent results about the CG impact on firm performance due to various factors (Michelberger, 2016).

In this context, we try to address these inconsistencies, focusing on a small European market (Euronext Lisbon) for the 2010–2022 period, introducing some new CG variables, like the board of directors' compensation and diversity.

In what concerns the impact of board size on firm performance, Anderson et al. (2004) suggest that larger boards are better at supervising managers, offering more expertise and resources. However,

Jensen (1993) maintains that larger boards lead to inefficiencies and higher agency costs. Some empirical studies (Koji et al., 2020; Akhter & Hassan, 2024) report a positive impact of board size on firm performance, while others (Detthamrong et al., 2017) find no significant relationship, and some (Mak & Kusnadi, 2005) report a negative relationship between the two variables. Considering the opinion of Anderson et al. (2004), and the recent empirical results, we expect that board size has a positive impact on firm performance.

In relation to the board member compensation, the agency theory suggests higher board compensation aligns interests with shareholders, enhancing performance. On the contrary, stewardship theory posits that board members may, despite compensation, behave in the companies' best interests. Empirical research is limited, and the results are not consensual. Although some studies (Jensen & Murphy, 1990) find a positive impact of board compensation on performance, Denis and McConnell (2003) find no evidence of a significative impact. Considering the assumptions of the agency theory, we anticipate a positive relationship between board member compensation and firm performance.

Regarding board meeting attendance, Koji et al. (2020) argue that frequent board meetings can reduce information asymmetry, enhance oversight, and mitigate conflicts. Nevertheless, the few studies on this topic reach different conclusions. Vafeas (1999) reports a negative relationship between board meetings and firm performance, Chou et al. (2013) find a positive relation, and Moreno Gomez et al. (2017) find no significant association between the two variables. Based on Koji et al. (2020), we anticipate that board meeting attendance impacts positively on firm performance.

The presence of female directors on the board improves board effectiveness through diverse expertise and sensitivity to social issues (Detthamrong et al., 2017; Toukabri & Jilani, 2023). Empirical studies generally support a positive correlation between female representation on boards and firm performance (Akhter & Hassan, 2024; Imes et al., 2024), though some studies (Kalita & Tiwari, 2023) show no significant influence. The theoretical arguments and the main empirical results lead us to look for a positive impact of gender diversity on firm performance.

Chief executive officer (CEO) duality (when the chairman of the board is also the CEO) can lead to agency conflicts and hinder oversight. Research typically concludes that CEO duality has a negative influence on firm performance (Bhagat & Bolton, 2008). Consequently, we have in prospect that duality has a negative impact on firm performance.

Finally, cultural diversity on boards enhances problem-solving, stakeholder relationships, and firm performance. The most of the empirical studies (Dodd et al., 2024) find evidence of a positive impact of foreign board members on firm performance. Thus, we expect a positive signal for the board's cultural diversity variable.

In order to perform our study, we adopt a panel data methodology, considering first the best model among the pooled ordinary least squares, the fixed effects model, and the random effects model, and after, adopting the two-step technique generalized methods of moments.

Overall, the results show that CG does not affect company performance in a consistent way, suggesting that the relation between CG characteristics and firm performance depends on the proxy employed to measure performance, which agrees with Michelberger's (2016) conclusion.

According to previous research on board size (Detthamrong et al., 2017), board compensation (Yermack, 1996; Denis & McConnell, 2003), meeting attendance (Moreno Gomez et al., 2017), gender diversity, and CEO duality (Kalita & Tiwari, 2023), our results show that CG does not significantly affect firm performance when we use the return on equity to measure firm performance. Considering the return on assets, the findings indicate that CEO duality has a negative influence on ROA and that board size and gender diversity have a beneficial impact on firm performance, which gives support to the results of Akhter and Hassan (2024) and Imes et al. (2024), among others.

This study sheds some light on the function of CG and adds to the continuing discussion over the impact of CG attributes on business performance.

Analyzing other CG dimensions, as well as understanding if the effects of CG on firm performance are linear or not can be beneficial to firms, society, and CG institutions.

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