THE WORLDWIDE GOVERNANCE INDICATORS, CORPORATE GOVERNANCE MECHANISMS, AND FINANCIAL PERFORMANCE OF FTSE 100 IN THE UK

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Abstract

This study explores the influence of World Governance Indicators (WGI) and corporate governance mechanisms on the financial performance of the firms listed on the Financial Times Stock Exchange 100 Index (FTSE 100) from 2000 to 2021, using panel data analysis with a generalized method of moments (GMM) estimation. Unlike previous studies that focus on either external governance or internal mechanisms, this research integrates both. Our findings reveal that WGI variables, particularly the rule of law, significantly enhance financial performance, highlighting the critical role of legal frameworks. Additionally, effective corporate governance mechanisms, such as executive compensation and board independence, positively impact profitability. Notably, we find that larger boards hinder performance, challenging prior studies that emphasize their benefits. This study offers a nuanced understanding of governance's dual dimensions, providing unique insights for policymakers and managers in enhancing governance frameworks in the United Kingdom (UK) retail sector.

Keywords: Corporate Governance, Financial Performance, Executive Compensation, Board of Directors

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1. INTRODUCTION

The relationship between corporate governance mechanisms and financial performance has garnered significant attention in the academic literature, particularly in the context of publicly listed firms. This study investigates the financial performance of the United Kingdom (UK) firms listed on the Financial Times Stock Exchange 100 Index (FTSE 100), focusing on the influence of World Governance Indicators (WGI) and corporate governance practices over the period from 2000 to 2021. The importance of governance structures in enhancing firm performance is underscored by a growing body of evidence suggesting that effective governance can lead to improved financial outcomes. For instance, research indicates that firms with robust corporate governance frameworks tend to achieve superior financial performance compared to those with weaker governance structures (Dănescu & Popa, 2020; Rajpara, 2018; Haque & Arun, 2016).

The WGI, which encompasses dimensions such as political stability, regulatory quality, and the rule of law, plays a crucial role in shaping the operational

environment for businesses. A positive correlation between the rule of law and financial performance highlights the necessity of effective legal frameworks in fostering business success (Ngwenze & Kariuki, 2017; Dănescu & Popa, 2020). Furthermore, the presence of stable regulatory conditions can mitigate uncertainties in the business environment, thereby reducing operational costs and encouraging innovation, which is essential for attracting investment (Iqbal & Kume, 2014). This aligns with findings from various studies that emphasize the significance of governance in enhancing firm value and operational efficiency (Liu & Sun, 2022; Hossain et al., 2020).

In addition to the WGI, corporate governance mechanisms such as board composition and executive compensation are pivotal in determining financial performance. The study reveals that firms with well-structured compensation packages for executives tend to perform better financially, confirming the notion that appropriate incentives align the interests of management with those of shareholders (Bawaneh, 2020; Lo & Wu, 2015). Moreover, the presence of independent directors on boards is associated with improved financial performance, as they provide essential oversight and help mitigate agency conflicts (Uwuigbe & Fakile, 2012; Bertin, 2017). Conversely, larger board sizes have been linked to inefficiencies in decision-making, suggesting that smaller boards may be more effective in enhancing firm value through streamlined governance processes (Muchtar et al., 2019; Javaid & Saboor, 2015).

The primary research question guiding this study is:

RQ: How do World Governance Indicators and corporate governance mechanisms affect the financial performance of FTSE 100 firms from 2000 to 2021?

This question is pertinent as it addresses the intersection of governance quality and financial outcomes, an area that remains underexplored in the context of the UK's largest firms. The findings of this study will contribute to the existing literature by providing empirical evidence on the impact of governance indicators on financial performance, offering valuable insights for policymakers and regulators. Additionally, this research is unique in its focus on the WGI's influence on FTSE 100 firms, emphasizing the necessity for sound governance practices and regulatory frameworks to foster stability and growth within the UK retail sector.

This research contributes to the existing literature by providing empirical evidence on the impact of governance indicators on the financial performance of FTSE 100 firms, thereby offering valuable insights for policymakers and regulators. Additionally, to the best of our knowledge, this study is the first of its kind to examine the impact of the WGI on the financial performance of FTSE 100 firms. Finally, the findings of the study underscore the necessity for sound governance practices and regulatory frameworks to promote stability and growth within the retail sector in the UK, ultimately fostering a conducive environment for business success.

The remainder of the paper is organized as follows. In Section 2, we review the literature and develop our hypotheses. In Section 3, we present a research sample and describe variables. In Section 4, we discuss the empirical findings. In Section 5, we present the conclusion.

2. LITERATURE REVIEW

The relationship between corporate governance and financial performance has garnered significant attention in recent years, particularly within the context of the FTSE 100 companies in the UK. Corporate governance encompasses the structures, processes, and practices that direct and manage a company, aiming to enhance accountability and long-term shareholder value while considering the interests of various stakeholders (Handa, 2018; Xia et al., 2018). The literature indicates a positive correlation between effective corporate governance and improved financial performance metrics, such as return on assets (ROA) and economic value added (EVA) (Beta & Kalalo, 2023; Aggarwal, 2013). Several studies have highlighted that strong corporate governance mechanisms, including board diversity, independence, and the separation of roles between the chief executive officer (CEO) and the board chair, contribute significantly to financial performance. For instance, research has shown that firms with well-governed boards tend to exhibit higher financial performance, as these boards are better equipped to mitigate agency problems and align the interests of management with those of shareholders (Kasbar et al., 2023; Yusuf & Sherif, 2020). Moreover, the presence of independent directors has been linked to enhanced decision-making processes, which in turn positively impacts financial outcomes (Nawaz & Pang, 2022; Kasbar et al., 2023). The impact of corporate governance on financial performance is not uniform across all sectors; however, evidence suggests that the benefits are particularly pronounced in industries with high agency costs, such as finance and insurance. A study focusing on the UK insurance sector found that specific governance mechanisms, such as board structure and oversight practices, significantly influenced performance during various economic cycles (Abdoush et al., 2022). This aligns with findings from other sectors, where corporate governance has been shown to play a critical role in sustaining financial performance, especially during periods of economic uncertainty (Hsiao & Zhang, 2023; Kasbar et al., 2023). This is supported by a study examining the corporate governance of insurance firms in Saudi Arabia, which found that effective governance mechanisms positively impacted financial performance by addressing issues of information asymmetry (Al-Faryan & Alokla, 2023). Such evidence underscores the critical role that corporate governance plays in safeguarding stakeholder interests and driving financial success. Furthermore, the relationship between corporate governance and financial performance may be moderated by external factors such as market conditions and regulatory frameworks. For example, the global financial crisis underscored the importance of robust governance structures in maintaining financial stability and performance (Abdoush et al., 2022). In the context of the FTSE 100, companies that adhered to stringent governance standards were better positioned to navigate the challenges posed by the crisis, thereby demonstrating superior financial resilience (Abdoush et al., 2022; Kasbar et al., 2023). In conclusion, the literature consistently supports the assertion that effective corporate governance is instrumental in enhancing the financial performance of FTSE 100 companies. The interplay between governance structures, market dynamics,

and firm performance underscores the necessity for ongoing research and policy development aimed at strengthening governance practices across industries. As the corporate landscape evolves, the emphasis on governance will likely remain a pivotal factor influencing financial outcomes.

In addition to the existing literature, several studies further elucidate the relationship between corporate governance and financial performance, particularly within the context of various industries and regions. For instance, Kobuthi et al. (2018) found that the combined effect of corporate governance mechanisms significantly enhances non-financial performance, suggesting that effective governance practices are crucial for overall firm success, which aligns with the findings of previous studies that established a positive relationship between governance and performance metrics (Kobuthi et al., 2018). Similarly, Carter et al. (2010) highlighted the importance of board diversity, noting that firms with diverse boards tend to exhibit superior financial performance, thereby reinforcing the notion that varied perspectives contribute to better decision-making processes (Carter et al., 2010). Padi and Musah (2022) further support this argument by demonstrating that competent leadership and good corporate governance practices are essential for improving the financial performance of small and medium-sized enterprises (SMEs) in Ghana, indicating that governance is a critical factor across different organizational sizes and contexts (Padi & Musah, 2022). In the Malaysian context, Bhatt and Bhatt (2017) provided evidence that strong corporate governance practices lead to improved firm performance, emphasizing the need for regulatory enforcement to ensure adherence to governance codes (Bhatt & Bhatt, 2017). Zhang (2024) also contributed to this discourse by examining emerging Asian economies, revealing that effective corporate governance, particularly board independence, positively impacts financial performance, thus corroborating the findings of earlier studies (Zhang, 2024). Finally, Hamad and Çek (2023) explored the moderating effects of corporate social responsibility on financial performance in Organization for Economic Co-operation and Development (OECD) countries, suggesting that good governance practices are integral to achieving financial success, especially in the context of social accountability (Hamad & Çek, 2023). Collectively, these studies underscore the multifaceted nature of corporate governance and its critical role in enhancing financial performance across various sectors and regions, reinforcing the need for ongoing research and policy development in this area.

3. RESEARCH METHODOLOGY

This paper employs an unbalanced dataset collected from the Bloomberg database over the period (2000–2021). We used an unbalanced panel in order to avoid sample selection issues associated with unreliable data for a number of firms. We also excluded firms with fewer than four years of data. Therefore, the final sample of our study comprises 47 firms of FTSE 100 in the UK. We have selected listed firms in the UK since they are expected to comply with regulations and laws. Additionally, listed firms are likely to prepare their financial statements in compliance with International Accounting Standards (IAS) (Ehikioya, 2009). An overview of all study variables is presented in the Appendix.

3.1. Empirical model

To examine the impact of corporate governance mechanisms on the firm performance of FTSE 100, we formulated the following model using the generalized method of moments (GMM) estimation:

$$P_{it} = \beta_0 + P_{it-1} + \beta_1 X_{it} + \beta_2 C_{it} + \beta_3 W_t + \beta_4 M_t + \varepsilon \quad (1)$$

where, the lowercase subscripts i and t represent firm i at time t, respectively; P specifies firm performance; P_{it-1} is used to represent the lag of the dependent variable; X_{it} denotes corporate governance variables; C_{it} is a vector of control variables; W represents WGI; and M captures macroeconomic variables.

To explain the model much further, we generated three equations to investigate the impact of corporate governance on firm performance.

$$ROA_{it} = \beta_0 + \gamma ROA_{it-1} + \beta_1 LAW + \beta_2 REG_{jt} + \beta_3 GOV_{jt} + \beta_4 COR_{jt} + \beta_5 POL_{jt} + \beta_6 LNBS_{it} + \beta_7 LNIND_t + \beta_8 LNCTE_t + \beta_9 ACM_{it} + \beta_{10} ACS_{it} + \beta_{11} PWB_{it} + \beta_{12} LNTA_{it} + \beta_{13} GDPGR_t + \beta_{14} CPI_t + \varepsilon \quad (2)$$

$$ROE_{it} = \beta_0 + \gamma ROE_{it-1} + \beta_1 LAW + \beta_2 REG_{jt} + \beta_3 GOV_{jt} + \beta_4 COR_{jt} + \beta_5 POL_{jt} + \beta_6 LNBS_{it} + \beta_7 LNIND_t + \beta_8 LNCTE_t + \beta_9 ACM_{it} + \beta_{10} ACS_{it} + \beta_{11} PWB_{it} + \beta_{12} LNTA_{it} + \beta_{13} GDPGR_t + \beta_{14} CPI_t + \varepsilon \quad (3)$$

$$Tobin's\ Q_{it} = \beta_0 + \gamma Tobin's\ Q_{it-1} + \beta_1 LAW + \beta_2 REG_{jt} + \beta_3 GOV_{jt} + \beta_4 COR_{jt} + \beta_5 POL_{jt} + \beta_6 LNBS_{it} + \beta_7 LNIND_t + \beta_8 LNCTE_t + \beta_9 ACM_{it} + \beta_{10} ACS_{it} + \beta_{11} PWB_{it} + \beta_{12} LNTA_{it} + \beta_{13} GDPGR_t + \beta_{14} CPI_t + \varepsilon \quad (4)$$

Following prior studies (Arora & Sharma, 2016; Paniagua et al., 2018), in this study, we use three measures of financial performance (*ROA, ROE,* and *Tobin's Q*) to represent a dependent variable. Where γROA_{it-1}, γROE_{it-1}, and $\gamma Tobin's\ Q_{it-1}$ are the lagged values of performance variables (*ROA, ROE,* and *Tobin's Q,* respectively) as shown in Eqs. (2), (3), and (4).

Regarding corporate governance mechanisms, this study uses various variables comprising board size, number of board meetings, compensation to CEOs, independent directors, audit committee meetings (ACMs), audit committee size, and board gender diversity. The board size (*LNBS*) is measured by the natural log of the number of board directors (Hassan Al-Tamimi, 2012; Liu et al., 2015; Shao, 2019). Regarding independent directors (*LNIND*), this variable is employed to represent the percentage of independent directors on the board of a company (Gugnani, 2013). The compensation to executives is denoted by *LNCTE* (Kato & Long, 2005). *ACM* and *ACS* represent ACMs and audit committee size

respectively (Abdullah & Tursoy, 2023; Al-Matari et al., 2012). Board gender diversity (*PWB*) is employed to represent board gender diversity as examined by (Liu et al., 2015; Martín-Ugedo & Mínguez-Vera, 2014). Compensation to executives (*LNCTE*) as stated in the financial statements of the FTSE 100 firms comprising both fixed salary components and performance-based bonuses as well as compensation in cash and stock-based incentives.

However, we also included control variables to be examined to assess the impact of other factors on the firm performance. Following previous studies (Nguyen et al., 2014), this paper employs firm size (*LNTA*). Firm size (*LNTA*) was measured by the logarithm of total assets. Regarding the WGI and as a result of high internal collinearity for some explanatory variables namely (control of corruption — *COR*, regulatory quality — *REG*, rule of law — *LAW*), the principal component analysis (PCA) is employed to eradicate this issue via generating a new variable (*WGI*) that combines all these correlated ones. This technique is utilised when data on several variables display some redundancy and is explained by inter-correlated quantitative variables. Macroeconomic variables are also investigated comprising real gross domestic product (*LNGDPGR*), consumer price index (*CPI*), and real interest rate.

3.2. GMM Arrelano-Bond estimation

Given the dynamic nature of this study, least squares estimation is inappropriate to be applied since it generates biased and inconsistent estimates (Baltagi, 2008). Also, the potential problem of omitted variable biases in parameter estimation is more likely to be faced in our estimation. Therefore, we utilized the dynamic GMM method to overcome the unobserved heterogeneity of the FTSE 100 sample.

This kind of method eliminates the problem of endogeneity and simultaneity bias. The method is expressly suitable in situations where instruments are difficult to be found to alleviate the problems. In *LNGDPGR* addition, as noted by Arellano and Bond (1991), this model should not be used if the study period is short, but this issue does not exist in our paper because it covers 22 years (2000–2021). However, to assess the validity of the Arellano-Bond model, we employed two diagnostic tests. Firstly, we tested whether there is the existence of first and second-order serial correlation among residuals, and this test should reject the second-order test to ensure the non-existence of serial correlation. Secondly, following the literature (Beck et al., 2008; Athanasoglou et al., 2008; Barth et al., 2003), we checked the validity of over-identification restrictions using the Sargan and F-tests to assess the suitability of the instruments (Baltagi et al., 2005).

This estimator uses an appropriate number of lags in level form as instruments for equations in first difference form and equally for equations in level form, all of which are integrated into a system of equations with choices to treat any of the variables in the system as endogenous. It is vital to recognise how many lags of dependent variables in the panel GMM model are required to capture all the information since too-long lags will lead to a loss of degrees of freedom and over-parameterization. Whereas, too-short lags might generate biased results produced by neglecting significant variables and the dynamics of variables will not be captured (Nguyen et al., 2014).

4. EMPIRICAL FINDINGS AND DISCUSSION

Tables 1, 2, and 3 demonstrate the results of Arellano-Bond regressions for FTSE 100. Estimations of GMM revealed a stable coefficient as the Sargan test, showing no evidence of over-identifying restrictions for all tables. Even though the tests imply that negative first-order autocorrelation is evident, this does not mean that estimates are inconsistent (Arellano & Bond, 1991). Additionally, the highly significant coefficient of lagged *Tobin's Q*, *ROA*, and *ROE* at 5% and 1% confirm the dynamic character of the model specification for FTSE 100. The positive impact of the rule of law (*LAW*) on the financial performance of FTSE 100 companies can be explained by several theoretical and empirical arguments. La Porta et al. (1998) argue that investor confidence can be enhanced by a robust rule of law as investors believe that risks related to financial returns to lower in environments with consistent enforcement of contracts, protection of property rights, and a transparent legal system. Therefore, more capital inflow toward companies then improves financial performance. Also, North (1990) and Shleifer and Vishny (1997) suggest that the transaction costs associated with financial activities can be reduced by sound legal institutions as strong legal institutions make firms more efficient. In our sample of FTSE 100 companies, reduced costs of funds resulted from superior lender and investor confidence that debts will be repaid, and contracts will be enforced leading to improved financial performance.

In respect to corruption control (*CC*), this variable is found to improve financial performance of FTSE 100 indicating that firms tend to perform better financially when they operate in environments with robust anti-corruption mechanisms. This result can be justified by a number of factors such as improved corporate governance, reduced risk, and improved investor confidence, all of which lead to superior financial performance. Shleifer and Vishny (1993) suggest that trust in corporate governance can be corroded by corruption, leading to misallocation of resources and decreased firm efficiency. In contrast, robust corruption control tools ensure that decisions are made in the best interests of shareholders and other stakeholders, reducing the potential for fraud, bribery, and embezzlement. Also, it is necessary to highlight that firm risk-taking is influenced by corruption control because the efficiency of capital allocation mechanisms by firms would otherwise be diminished. Mauro (1995) argues that the cost of business activities is increased by a high level of corruption leading to misleading market structure and decreasing investment incentives. In this matter, firms operating in a corrupted environment will be extremely involved in corrupt practices, and thus they are more likely to face postponements in obtaining licences, higher transaction costs, and unstable legal environments.

Table 1. Arellano-Bond-GMM model: Results of financial performance using *Tobin's Q*

Variable	***LNTobin's Q***			
LNTobin's Q	0.0481**	0.0385*	0.161***	0.415***
	(2.17)	(1.76)	(7.43)	(27.22)
REG	0.0588	-0.0455	-0.336***	-0.0577
	(0.85)	(-0.78)	(-6.81)	(-1.26)
LAW	1.509***	1.340***	0.362***	0.174**
	(6.09)	(5.58)	(5.38)	(2.36)
GOV	-1.090***	-1.056***	-0.538***	-0.264***
	(-7.43)	(-7.41)	(-6.19)	(-3.23)
CC	0.984***	1.088***	0.642***	0.200**
	(7.50)	(9.04)	(6.12)	(2.23)
POL	0.513***	0.486***	0.276***	0.174***
	(8.35)	(9.25)	(7.89)	(5.74)
LNIND	0.159***	0.172***	0.186***	0.163***
	(3.19)	(4.39)	(5.97)	(4.83)
LNCTE	0.0409***	0.0427***	0.0632***	0.0392***
	(3.46)	(4.75)	(6.44)	(3.22)
LNBS	-0.232***	-0.240***	-0.176***	-0.305***
	(-3.92)	(-3.96)	(-3.86)	(-5.46)
ACS	0.000506	0.00350	0.0103**	0.00498
	(0.08)	(0.59)	(2.33)	(1.17)
ACM	-0.0242***	-0.0232***	-0.00856***	-0.00967**
	(-4.59)	(-5.50)	(-3.43)	(-2.47)
PWB	0.00959	0.0148	-0.0100	-0.00509
	(0.92)	(1.36)	(-1.55)	(-0.54)
LNTA	-0.420***	-0.427***	-0.351***	
	(-23.38)	(-32.85)	(-14.77)	
LNGDPGR	-0.307***	-0.260***		
	(-5.55)	(-5.11)		
CPI	0.590			
	(1.39)			
_cons	-0.905	2.072***	2.665***	-0.138
	(-0.44)	(5.02)	(9.92)	(-0.84)
Sargan test	34.141	33.792	34.702	
Arellano-Bond test	0.40836 0.6830 0.36589 0.7144	0.34942 0.7268 0.13323 0.8940	-3.3246 0.0009 0.1919 0.8478	-2.4021 0.0163 1.068 0.2855
Wald Chi² p-value	40802.12 0.0000	99119.34 0.0000	7264.40 0.0000	3544.89 0.0000

*Note: t-statistics in parentheses, * p < 0.10, ** p < 0.05, *** p < 0.01.*

Table 2. Arellano-Bond-GMM model: Results of financial performance using *ROA*

Variable	***LNROA***			
LNROA	-0.0184	-0.0205	-0.0720**	-0.0467
	(-0.60)	(-0.62)	(-2.50)	(-0.90)
REG	0.785	0.998**	0.590**	0.785***
	(0.95)	(2.32)	(2.50)	(2.79)
LAW	2.541***	1.552	-0.530**	-0.686*
	(2.96)	(1.57)	(-2.37)	(-1.73)
GOV	-1.103*	0.0210	0.683**	0.812***
	(-1.76)	(0.03)	(2.57)	(3.37)
CC	0.687	-0.603	-0.908*	-0.778*
	(0.86)	(-1.21)	(-1.73)	(-1.65)
POL	0.536*	0.126	-0.112	-0.1000
	(1.81)	(0.39)	(-0.80)	(-0.55)
LNIND	-0.415	-0.279	-0.219	-0.754***
	(-1.41)	(-1.05)	(-0.87)	(-2.90)
LNCTE	0.159**	0.201***	0.172***	0.0794
	(2.42)	(3.45)	(4.95)	(1.57)
LNBS	-0.445	-0.672	-0.722	0.635
	(-1.01)	(-1.55)	(-1.03)	(0.85)
ACS	0.125***	0.124***	0.0995**	0.0341
	(3.38)	(3.57)	(2.50)	(0.76)
ACM	-0.0159	-0.0109	-0.0300	-0.0743***
	(-0.68)	(-0.42)	(-1.52)	(-3.62)
PWB	-0.0564	-0.0841*	-0.0176	-0.0236
	(-0.98)	(-1.73)	(-0.49)	(-0.51)
LNTA	-0.623***	-0.601***	-0.601***	
	(-4.66)	(-5.83)	(-8.60)	
LNGDPGR	-0.759***	-0.677***		
	(-3.35)	(-2.86)		
CPI	-2.172			
	(-1.14)			
_cons	12.20	3.319	7.234***	0.364
	(1.63)	(1.47)	(6.08)	(0.26)
Sargan test	24.688	24.10859	26.493	30.989
Arellano-Bond test	-2.0456 0.0408 0.42359 0.6719	-2.0427 0.0411 0.22231 0.8241	-2.8453 0.0044 -1.4939 0.1352	-2.7665 0.0057 -1.5927 0.1112
Wald Chi² p-value	1149.62 0.0000	1964.38 0.0000	607.64 0.0000	137.49 0.0000

*Note: t-statistics in parentheses, * p < 0.10, ** p < 0.05, *** p < 0.01.*

Table 3. Arellano-Bond-GMM model: Results of financial performance using *ROE*

Variable	*LNROE*			
LNROE	-0.180***	-0.203***	-0.273***	-0.213**
	(-6.69)	(-6.33)	(-2.64)	(-1.98)
REG	0.278	0.525**	0.559*	0.870**
	(0.94)	(2.18)	(1.79)	(2.13)
LAW	3.144***	2.461**	-0.763***	-0.716**
	(3.60)	(2.04)	(-3.70)	(-2.49)
GOV	-1.763***	-0.962	0.430	0.254
	(-2.65)	(-1.21)	(1.56)	(0.89)
CC	1.785***	0.760	0.0407	-0.234
	(3.09)	(1.45)	(0.09)	(-0.43)
POL	0.714***	0.375	-0.260**	-0.279*
	(3.14)	(1.07)	(-2.22)	(-1.69)
LNIND	-0.309	-0.488	-0.700*	-0.963**
	(-0.84)	(-1.32)	(-1.79)	(-2.24)
LNCTE	0.135**	0.180***	0.132***	0.0792**
	(2.30)	(3.71)	(3.45)	(2.40)
LNBS	0.0854	-0.258	0.722	0.567
	(0.16)	(-0.51)	(1.22)	(1.03)
ACS	0.0510	0.111**	0.0168	0.0708**
	(1.55)	(2.38)	(0.44)	(2.00)
ACM	-0.0482***	-0.0391**	-0.0502**	-0.0273
	(-3.90)	(-2.30)	(-2.51)	(-1.54)
PWB	-0.0242	-0.0907	0.0225	0.0759
	(-0.22)	(-1.25)	(0.19)	(0.40)
LNTA	0.104**	0.0595	-0.163	
	(2.49)	(1.28)	(-1.40)	
LNGDPGR	-0.753***	-0.803***		
	(-5.07)	(-3.26)		
CPI	-3.452*			
	(-1.93)			
_cons	11.08	-2.830	2.783**	2.359*
	(1.50)	(-1.35)	(2.00)	(1.89)
Sargan test	31.111	31.565	36.179	29.932
Arellano-Bond test	-0.45551 0.6487 -0.138 0.8902	-0.24911 0.8033 0.08242 0.9343	-1.2068 0.2275 -1.5058 0.1321	-1.5948 0.1108 -0.97385 0.3301
Wald Chi^2 p-value	4510.72 0.0000	1340.26 0.0000	420.61 0.0000	448.12 0.0000

*Note: t-statistics in parentheses, * p < 0.10, ** p < 0.05, *** p < 0.01.*

Regarding political stability (*POL*), this variable is found to be positive in most regressions. The positive relationship between political stability and the financial performance of FTSE 100 companies indicates that a politically stable environment plays a crucial role in improving the financial performance of FTSE 100 in line with Rodrik (1991) and Acemoglu et al. (2005) who argued that uncertainties associated with economic and fiscal policies, and social unrest are reduced by political stability. Additionally, La Porta et al. (1997) advocate that political stability promotes the development of anti-corruption measures, which are necessary for protecting investor rights and safeguarding an attractive investment environment. In our case, the FTSE 100 firms, have benefited from a politically stable environment as such environment helps to generate higher sales, improved financial performance, and superior access to financial resources.

Most of the regression findings of regulatory quality (*REG*) suggest that effective and steady regulatory environments lead to improving the profitability of FTSE 100, aligned with Demirgüç-Kunt and Detragiache (1998) and Ben Bouheni (2014) who suggest that sound regulatory and supervisory frameworks, and compliance contribute to enhanced financial stability. According to La Porta et al. (1998), better capital market performance and higher financial performance from large firms can be seen in countries with robust regulatory structures. This predictability reduces risk, attracting more investments, improving access to credit, and enhancing firm financial performance. Also, as argued by Kaufmann et al. (2011), regulatory quality frameworks attract foreign direct investment by facilitating a secure, stable, and transparent business environment. All of these contribute to attracting foreign investors and hence they will have access to credit, and enhance firm profitability.

Moving to corporate governance variables, the positive relationship between the proportion of independent directors on a company's board and its profitability suggests that having more independent directors contributes positively to improving the financial performance of FTSE 100 firms. This relationship is in line with Fama and Jensen (1983) and Bhagat and Black (2002), who argued that firms with more independent directors are more likely to make decisions in favour of profitability, which is particularly relevant for FTSE 100 firms operating in dynamic and competitive markets. In the same context, Duchin et al. (2010) outlined that companies with higher stock valuations are seen with a greater proportion of independent directors. Also, Hillman and Dalziel (2003) suggested the monitoring and resource-provision roles of boards are enhanced by independent directors leading to increased firm performance.

With respect to compensation to executives (*LNCTE*), this variable is found positive in all tables confirming the argument that higher compensation packages for executives are associated with superior financial performance. Jensen and Meckling (1976) argued that there is a potential conflict of interest between shareholders (principals) and executives

(agents) in large firms. Therefore, higher compensation should be linked to financial performance to bring the interests of executives with shareholders. Also, Lazear (2000) claims higher levels of effort from executives are associated with performance-linked incentives. In our sample of FTSE 100 firms, directors who are compensated based on financial performance such as stock price appreciation or profitability are motivated to implement policies that lead to improved financial performance and stock price.

Regarding the board size (*LNBS*), in Table 1, there is a negative relationship between the financial performance of FTSE 100 and board size suggesting that the increase in the number of board members tends to decrease the financial performance using *Tobin's Q* variable. This finding can be explained by agency problems associated with larger boards where the interests of the board members may diverge from those of the shareholders (Jensen, 1993). In addition, Lipton and Lorsch (1992) emphasised that larger boards are more likely to face problems in making decisions due to diverse opinions and experience. This inadequacy can adversely impact the board to react to market changes, and thus the financial performance is diminished. On the other hand, smaller boards tend to be more organized, leading to quicker and more efficient decision-making. Another reason is associated with risk-taking and innovation. Coles et al. (2008) argued larger boards are more likely to be risk-averse due to the diverse opinions and perspectives. Regression findings of ACMs show a negative relationship between ACMs and financial performance of FTSE 100 companies signifying that more frequent ACMs may be related to lower financial performance. This negative relationship can be justified by that the frequent ACMs may indicate that firms face a number of issues. Raghunandan and Rama (2007) suggested that, in the period of financial distress, companies are more motivated to increase the frequency of ACMs. In this context, the higher number of meetings reflects a reactive approach to addressing existing problems rather than proactive governance. Also, Jensen (1993) suggested that the increase in the number of meetings may indicate some operational issues, which negatively affect the decision-making process. Likewise, Zalata et al. (2018) highlighted that the audit committee's effectiveness can be diminished by frequent ACMs.

Regression tables show a negative relationship between company size measured by total assets (*LNTA*) and financial performance of FTSE 100 companies in line with findings by Goddard et al. (2005) and Demsetz and Villalonga (2001). This finding can be explained by a concept of diseconomies of scale as a company grows in size, its operating costs will rise, resulting in inefficiencies of its resources. In this regard, Mueller (1986) argued that large firms are more exposed to higher bureaucratic costs, and their operations are not managed properly.

5. CONCLUSION

This paper investigated whether the financial performance of FTSE 100 firms is impacted by the WGI and corporate governance mechanisms. We employed panel data analysis using GMM estimation to investigate such issues. A sample of 47 firms of FTSE 100 in the UK was selected over the period of 2000–2021. According to the findings we reached, the WGI variables play a major role in improving the financial performance of FTSE 100 firms. The positive relationship between the rule of law and the financial performance of FTSE 100 firms emphasises the importance of law enforcement in business success. Also, uncertainty in the business environment can be eliminated by robust regulation and political stability as they can contribute to lower operational costs, encourage innovation, and attract more investment.

In respect to corporate governance mechanisms, findings acknowledge a positive and significant relationship between financial performance and compensation paid to executives confirming that firms with well-structured compensation packages are more profitable and perform better in the industry. Findings also showed that firms with more independent directors tend to perform better implying that essential oversight and elimination of agency conflicts can be accomplished by independent directors. The negative relationship between board size and financial performance in FTSE 100 companies can be associated with agency problems leading to inefficiencies in decision-making. Accordingly, smaller boards are more effective in enhancing firm value due to robust oversight, faster decision-making processes, and improved financial performance.

The limitations we faced in this study are associated with focusing entirely on firms listed on the FTSE 100 in the UK, which limits the generalizability of the findings to smaller firms or firms in other markets. Also, the unavailability of data before 2000 suggests that findings may not capture long-term trends or recent developments in corporate governance and financial performance. Future research could extend the examination to include companies from European and emerging countries, authorising comparative visions into how governance tools impact financial performance in different legal, market concentration, and institutional environments. Finally, this study is beneficial since it examined the impact of WGI on the performance of the FTSE 100 in the UK enabling policymakers and regulators to formulate sound policies in favour of the stability of these firms.

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APPENDIX. VARIABLE DEFINITION

Variable	*Definition*	*Source*
LN	Natural logarithm	Generated by authors
ROA	Return on assets measured by net income divided by total assets	Bloomberg database
ROE	Return on equity measured by net income divided by total equity	Bloomberg database
Tobin's Q	Total market value of firm / Total assets value of firm	Bloomberg database
COR	Control of corruption. An estimate ranging between +2.5 (high) and -2.5 (low) has reflected perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests.	WGI, World Bank outlook
REG	Regulatory quality. Indicates the ability of the government to formulate and implement sound policies and regulations that permit and promote private-sector development. Estimates of this index range between +2.5 (high) and -2.5 (low).	WGI, World Bank outlook
POL	Political stability and absence of violence/terrorism. Expresses the likelihood that the government will be destabilized by unconstitutional or violent means, including terrorism. Estimates range between +2.5 (high) and -2.5 (low).	WGI, World Bank outlook
GOV	Government effectiveness. Estimates can take values between +2.5 (high) and -2.5 (low). The quality of public services, the capacity of the civil service and its independence from political pressures; and the quality of policy formulation.	WGI, World Bank outlook
LAW	Rule of law. The extent, to which agents have confidence and abide by the rules of society, including the quality of contract enforcement and property rights, the police, and the courts, as well as the likelihood of crime and violence. Index values, range between +2.5 (high) and -2.5 (low).	WGI, World Bank outlook
LNBS	The number of directors on a company's board and measured by the Natural logarithm of board size	Bloomberg database
LNIND	The proportion of independent directors on a company's board	Bloomberg database
LNCTE	The amount and structure of compensation paid to directors for their service on a company's board	Bloomberg database
ACM	Number of audit committee meetings	Bloomberg database
ACS	Audit committee size	Bloomberg database
PWB	Board gender diversity	Bloomberg database
LNTA	The natural logarithm of a firm's total assets	Bloomberg database
LNGDPGR	Natural logarithm of the real gross domestic product	World Bank outlook
CPI	Consumer price index	World Bank outlook