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CORPORATE GOVERNANCE INFLUENCE ON MARKET VALUE: ANALYTICAL STUDY

Annotation: *Countries around the world are characterized by alternative corporate governance systems (Shleifer and Vishny (1997)). Considerable debate is going on illustrating how good, superior or effective these systems are. Prowse (1995) suggests that such judgements are inherently subjective because of the sparse evidence on the relative performance of different corporate governance systems. This study is focused on how corporate governance maintains the firm performance and protects the shareholders interest and wealth of the organization. We empirically analyze the effect of different corporate governance systems on firm performance by examining a sample of industrial companies over four years period 2018-2021.*

Keywords: *Corporate Governance, Influence, Market Value, Analytical Study*

Introduction. Countries around the world are characterized by alternative corporate governance systems (Shleifer and Vishny (1997)). Considerable debate is

going on illustrating how good, superior or effective these systems are. Prowse (1995) suggests that such judgements are inherently subjective because of the sparse evidence on the relative performance of different corporate governance systems. This study is focused on how corporate governance maintains the firm performance and protects the shareholders interest and wealth of the organization. We empirically analyze the effect of different corporate governance systems on firm performance by examining a sample of industrial companies over four years period 2018-2021. The firm-level panel regressions that we perform in our analysis are based on approximately 80 observations.

Literature review. Jensen and Meckling (1976) and Fama and Jensen (1983) argue that the diffusion of ownership has an important impact on the validity of the profit-maximising goal of corporations because the separation of control may enable corporate managers to pursue their own interests. This creates beneficial effects for firms in the sense that performance or profitability improves (Morck et al. (1989)). On the other hand, there are studies which find that higher ownership concentration lead to detrimental effects for corporations as large block holders and managers can collude to extract rents from small shareholders (Lehman and Weigand (2000)).

Demsetz and Lehn (1985) state that a relation between ownership and performance is not to be expected because ownership-induced inefficiencies cannot be maintained. Ownership concentration will be adjusted to maintain the highest possible profitability. In a rational world, equity can act as a commitment device to delegate a certain degree of authority from shareholders to management (Burkart et al. (1997) and Bolton and von Thadden (1998)). Equity control should be state-contingent: in some states of the world (e.g. with low corporate profitability), close monitoring resulting from strong ownership concentration is desirable. In other states, close monitoring may reduce managerial discretion and hence management's effort. Another dimension of ownership structure is concerned with the identity of shareholders which also has implications for corporate governance. Demsetz and Lehn (1985) point out that individuals and families, financial institutions and corporations may have different objectives, monitoring skills as well as different

monitoring incentives. Individual block holders are usually strongly involved with the events of a firm, and their monitoring can significantly enhance firm performance. Financial institutions have the skills and resources to monitor managers, but they can also align with managers in order to foster their other interests in the firm.

A deficiency of most of the U.S. empirical research is that they usually only focus on insider ownership concentration and thus ignore the presence of block holders. Insider ownership concentration per se is not a good proxy for agency costs, but rather *relative* insider control. Morck et al. (1988) and McConnell and Servaes (1990) show that the impact of equity ownership may change over different levels of ownership. The relation increases up to ownership levels of 40-50% and subsequently decreases. Still, these findings are not confirmed by Loderer and Martin (1997), Cho (1998) and Himmelberg et al. (1999) who consider equity ownership as endogenous. Several outside directors are in fact former employees or advisers of a firm. In sum, both theoretical and empirical studies suggest that the relation between corporate governance characteristics and corporate performance can be positive, negative or none.

A. Data sources

We identify a time period of four years and construct a sample of 100 firms. These firms are listed on UK stock exchange, and are selected after first matching on the basis of industry and then on firm size. All corporate governance data of British companies are collected from annual reports of the 20 manufacturing companies. These data are collected for the four-years period from 2018 through 2021.

B. Variable definitions

The variables used in our analysis are classified into two categories: corporate governance characteristics and performance measures. We use the natural logarithm of the book value of total assets in the regression analyses to account for inherent skewness of this variable. The leverage variable used in our analysis is the percent of total assets financed by total debt (in book value terms). We identify widely used corporate governance characteristics of firms. These are grouped under board structure and ownership structure categories. The total number of directors sitting on

the board is used to calculate the board size variable. Also the variables includes Board Meetings, Board Independence, Number of Directors, and Number of Non-Executive Directors. We examine three different measures of firm performance namely Tobin's Q, Tangibility and Leverage. Tobin's Q-ratio (Q), is a hybrid one. It is measured by dividing the sum of the market value of equity and the book value of debt by the book value of total assets. Tangibility is the attribute of being easily detectable with the senses.The last performance metric we use is the Leverage. Leverage is the amount of debt that the entity uses to acquire more property. Leverage is utilized to avoid using too much equity to finance operations. Since no consensus exists in the literature on the use of a reliable performance measure, we believe that these three variables would reflect company performance in a robust way.

C. Descriptive statistics

Table 1 reports descriptive statistics for Board characteristics (Panel A), corporate Audit characteristics (Panel B) and firm performance measures (Panel C) for each year separately. Note that the number of observations for each year and for each variable is approximately 20. According to Panel A, the mean number of directors, NED and Board meeting are more or less the same for the four years. Looking at the leverage ratio, the average leverage ratios of UK firms in the sample are 13.9%, 11.8%, 14% and 9%, respectively. Analyzing the characteristics in Panel A, B, and C we observe that means of almost all variables are approximately yields the same figure for different time period.

Research design

The descriptive analysis above shows that there are slight significant differences among corporate governance characteristics as well as performance in the samples of companies over four years period. In order to study whether the observed differences in performance are related to the differences in corporate governance characteristics associated with firm performances, we estimate the following basic regression model:

Performance = f (corporate governance variables, control variables)

The model uses firm performance as the dependent variable. As mentioned earlier, three different proxies (Tangibility, Q and Leverage) are used to measure firm performance. We use two types of proxies to represent a country's corporate governance system: board characteristics and ownership characteristics. The variable includes board leadership (if the positions of chairman and the CEO were held by single person or two separate persons), composition of the board (number of non-executive directors), board committees, audit committees and financial reporting.

The first set of regression equations that we estimate can be specified as follows:

$$\textit{Performance } i, t = \beta 0 + \beta 1 \textit{ Board\_meetings } i, t + \beta 2 \textit{ Audit\_meetings } i, t + \beta 3 \textit{ Non\_Executive\_Directors}i,t + \beta 4 \textit{ Audit\_size } i, t + \beta 5 \textit{ Number\_of\_Directors } i, t + \beta 6 \textit{ Audit\_Independece } i, t + \varepsilon\, i, t\,,$$

where *i* and *t* represent all 100 firms in our sample and the four years periods, respectively, and $\varepsilon i, t$ is an error term.

The important advantages of a panel regression are that it will yield more accurate estimators and reduce the effect of omitted variables in comparison to pure cross-section or time-series regressions.

The second set of regression equations that we estimate can thus be specified as follows:

$$\textit{Performance } i, t = \beta 0 + \beta 1 \textit{ Board\_meetings } i, t + \beta 2 \textit{ Audit\_meetings } i, t + \beta 3 \textit{ Non\_Executive\_Directors}i,t + \beta 4 \textit{ Audit\_size } i, t + \beta 5 \textit{ Number\_of\_Directors } i, t + \beta 6 \textit{ Audit\_Independece } i, t + \varepsilon\, i, t\,,$$

Our third set of regression equations is specified as follows:

$$\textit{Performance } i, t = \beta 0 + \beta 1 \textit{ Board\_meetings } i, t + \beta 2 \textit{ Audit\_meetings } i, t + \beta 3 \textit{ Non\_Executive\_Directors}i,t + \beta 4 \textit{ Audit\_size } i, t + \beta 5 \textit{ Number\_of\_Directors } i, t + \beta 6 \textit{ Audit\_Independece } i, t + \varepsilon\, i, t\,,$$

Finally, we estimate three separate set of regressions, in which we include an intercept, control variables and the common governance variables, as in the above three equations.

Empirical results

Table 1

Descriptive statistics for Board Characteristics, Audit Characteristics and Finance and Organisational performance measures

Panel A

	Table 1.1 Board Characteristics					
	No.of Directors		NED		Board Meeting	
Year	Mean	Std.Dev	Mean	Std.Dev	Mean	Std.Dev
2018	12.57895	3.88621	8.63158	2.6872	9.176471	5.386142
2019	13.00	6.090545	9.1875	4.42808	9.0625	4.689013
2020	12.95	2.874113	9.00	2.2711	9.10	3.30709
2021	12.78947	4.307582	8.78947	3.40704	8.894737	3.363504

Panel B

	Table 1.2 Audit Committee Characteristics					
	Audit Size		Audit Independence		Audit Meeting	
Year	Mean	Std.Dev	Mean	Std.Dev	Mean	Std.Dev
2018	4.529412	2.033276	1.994258	0.901827	5.941176	3.410124
2019	4.3125	1.986136	2.192222	1.129654	5.80	3.513508
2020	4.20	0.833509	2.215833	0.704652	6.00	2.406133
2021	4.210526	1.414214	2.267544	1.346816	6.578947	3.160197

Panel C

	Table 1.3 Finance and Organizational Performance					
	Tobin's Q		Tangibility		Leverage	
Year	Mean	Std.Dev	Mean	Std.Dev	Mean	Std.Dev
2018	0.569775	1.385232	0.316967	0.25656	0.139384	0.620117
2019	0.274074	0.614241	0.346404	0.284558	0.118212	0.620075
2020	0.483774	1.243088	0.310547	0.271482	0.140598	0.612812
2021	0.212462	0.442005	0.369257	0.270504	0.090301	0.586768

Table 2

Estimation of relationship between Corporate Governance Characteristics and Firm Performance

Panel A: Model Summary

Model	**R**	**R Square**	**Adjusted R Square**	**Std. Error of the Estimate**
1	0.563[a]	0.317	0.277	0.88341
2	0.751[b]	0.565	0.510	0.72728

a. Predictors: (Constant), Board_meetings

b. Predictors: (Constant), Board_meetings, Audit_Independence

Panel B : ANOVA[a]

Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	6.169	1	6.169	7.905	0.012[b]
	Residual	13.267	17	0.780		
	Total	19.436	18			
2	Regression	10.973	2	5.487	10.373	0.001[c]
	Residual	8.463	16	0.529		
	Total	19.436	18			

a. Dependent Variable: Tobin's Q

b. Predictors: (Constant), Board meetings

c. Predictors: (Constant), Board meetings, Audit Independence

Panel C : Coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	2.005	0.599	(-0.563)	3.345	0.004
	Board_meetings	(-0.175)	0.062	(-0.676)	(-2.812)	0.012
2	(Constant)	0.248	0.764		0.324	0.750
	Board_meetings	(-0.210)	0.053		(-3.995)	0.001
	Audit_Independence	1.010	0.335	0.510	3.014	0.008

a. Dependent Variable: TobinsQ

Table 3

Estimation of relationship between Corporate Governance Characteristics and Firm Performance

Panel A: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.715[a]	0.511	0.285	0.21940

a. Predictors: (Constant), Audit_meetings, Non_Executive_Directors, Audit_size, Board_meetings, Number_of_directors, Audit_Independence

Panel B : ANOVA

Model	Sum of Squares	df	Mean Square	F	Sig.
Regression	0.654	6	0.109	2.265	0.102[b]
Residual	0.626	13	0.048		
Total	1.280	19			

a. Dependent Variable: Tangibility

b. Predictors: (Constant), Audit_meetings, Non_Executive_Directors, Audit_size, Board_meetings, Number_of_directors, Audit_Independence

Panel C : Coefficients

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	0.016	0.372		0.043	0.967
Number_of_ directors	(-0.015)	0.030	(-0.152)	(-0.481)	0.638
Non_Executive Directors	(-0.134)	0.052	(-1.042)	(-2.592)	0.022
Board_meetings	(-0.001)	0.024	(-0.011)	(-0.036)	0.972
Audit_size	0.199	0.081	0.662	2.445	0.030
Audit Independence	0.405	0.135	1.047	2.998	0.010
Audit_meetings	(-0.005)	0.027	(-0.049)	(-0.169)	0.869

a. Dependent Variable: Tangibility

Table 4

Estimation of relationship between Corporate Governance Characteristics and Firm Performance

Panel A : Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.778[a]	0.606	0.424	0.19887

a. Predictors: (Constant), Audit_meetings, Non_Executive_Directors, Audit_size, Board_meetings, Number_of_directors, Audit_Independence

Panel B : ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	0.790	6	0.132	3.330	0.033[b]
	Residual	0.514	13	0.040		
	Total	1.304	19			

a. Dependent Variable: Leverages

b. Predictors: (Constant), Audit_meetings, Non_Executive_Directors, Audit_size, Board_meetings, Number_of_directors, Audit_Independence

Panel C: Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	T	Sig.
		B	Std. Error	Beta		
1	(Constant)	0.394	0.337		1.167	0.264
	Number_of_directors	0.018	0.028	0.189	0.666	0.517
	Non_Executive_Directors	0.115	0.047	0.886	2.456	0.029
	Board_meetings	0.012	0.022	0.152	0.555	0.588
	Audit_size	(-0.094)	0.074	(-0.311)	(-1.279)	0.223
	Audit_Independence	(-0.422)	0.122	(-1.081)	(-3.448)	0.004
	Audit_meetings	0.016	0.025	0.170	0.650	0.527

a. Dependent Variable: Leverages

Table 2 presents the results of the multiple regression models using the full data set. There are about 80 observations pooled over four years. In Panel A (Model Summary), we start with pooled data from all firms with firm characteristics. We

include Board meetings and Audit Independence as the explanatory variables. The R-Square value indicates the variance in the dependent variable can be predicted from the independent variables. The result in the column R square shows that board meetings is 31.7% influencing on Tobin's Q (0.317) and the combination of board meetings and audit independence are influencing 56.5% on Tobin's Q as (R = 0.565). 27.7% of variability is explained by the predictor Board meetings and 51.1% of variability is explained by the predictors Board meetings and Audit Independence towards Tobin's Q. In Panel B (ANOVA), we examines that both board meetings and audit independence has a significantly positive impact for Tobin's Q. Since the significant value of both Board_meetings and Audit_Independence are less than 0.05, we conclude that the group of independent variables reliably predict the dependent variable (Tobin's Q). Thus, there is a statistically significant relationship between

(a) Tobin's Q and Board meetings and (b) Tobin's Q and Audit Independence.

In Panel C (coefficients), the results in the column B show that the Tobin's Q is significantly negatively influenced by the board meetings whereas the Audit_Independence has a significantly positive coefficient. This tells that the amount of increase in Tobin's Q that would be predicted by a 1 unit increase in the predictors. Since the p-value for Audit Independence (0.008) is less than 0.05, there exists a significant relationship between the variables. The p-value (0.012) for Board meetings indicates that there is no significant relationship between the variables. From this result, board meetings are more influencing the Tobin's Q than Audit Independence. The analysis in Panel A and B assumes that the impact of our governance variables is the same for other firm performances. This allows us to see to what extent corporate governance variables produce a differential effect over three firm performances.

Table 3 presents the results of regressions of corporate performance on firm (Tangibility) - corporate governance variables.

In Panel A (Model Summary), Board meetings, Audit meetings, Non-Executive Directors, Audit size, Number of directors and Audit Independence are considered as

the explanatory variables. 28.5% of variability is explained by the predictors towards Tangibility.

In Panel B (ANOVA), we explains that the group of independent variables (board independence, board size, audit size, their meetings and audit independence) doesn't show a statistically significant relationship with Tangibility.

In Panel C (coefficients), the results in the column B show that the Tangibility is significantly negatively influenced by the board meetings, Number of directors, Non-Executive directors and Audit meetings whereas the Audit_Independence and Audit size has a significantly positive coefficient. From Panel C, the regression equation is,

Y (Tangibility) = 0.016 - 0.015(Number of Directors) - 0.134(Non-Executive Directors)- 0.001(Board Meetings) + 0.199(Audit size) + 0.405(Audit Independence) – 0.005(Audit Meetings)

The coefficients of Non-executive directors (0.022), audit size (0.030) and audit independence (0.010) shows the significant relationship with tangibility since the p-value are less than 0.05.

Table 4 presents the results of regressions of corporate performance on firm (Leverages) - corporate governance variables.

In Panel A (Model Summary), Board meetings, Audit meetings, Non-Executive Directors, Audit size, Number of directors and Audit Independence are considered as the explanatory variables. 42.4% of variability is explained by the predictors towards Leverages.

In Panel B (ANOVA), we explains that the group of independent variables (board independence, board size, audit size, their meetings and audit independence) show a statistically significant relationship with Leverages.

In Panel C (coefficients), the results in the column B show that the Leverage is significantly negatively influenced by the Audit_Independence and Audit size whereas board meetings, Number of directors, Non-Executive directors and Audit meetings has a significantly positive coefficient.

From Panel C, the regression equation is,

Y (Leverages) = 0.394 + 0.018 (Number of Directors) + 0.115 (Non-Executive Directors) + 0.012 (Board meetings) – 0.094 (Audit size) – 0.422 (Audit Independence) + 0.016 (Audit meetings)

The coefficients of Non-Executive Directors (0.029) and Audit Independence (0.004) shows there exists a statistically significant relationship with leverages since the p-values are less than 0.05. Overall, our results show that corporate governance features are important in different studies for two reasons. First, variables have different impact on performance. Second, companies have unique institutional features that influence performance.

Conclusion. The purpose of this paper is to examine whether differences in corporate governance features can explain the differences in corporate performance. Whereas most studies on the relation between performance and control focus on the United States, this study helps to improve the empirical insight into the relationship between governance and performance. The present study is an attempt in analyzing the impact of corporate governance in the determination of firm value. The study also aimed at analyzing the significant differences in the corporate governance characteristics. We assemble a small but unique data set comprising of 20 Britain companies for the period of 2018 to 2021. These data's are chosen because their corporate governance characteristics differ significantly on many dimensions. We can draw the following major conclusions from this study. The OLS regression results shows that there exists a good link of board structure and audit independence with Tobin's Q and leverages. These common corporate governance features do not have similar relationship with firm performances. Our results indicate that in cases where a statistically significant relationship with performance is observed, there is no consistency concerning the direction of such relationship. The corporate governance characteristics are found to be more important in determining performance of firms.

The significantly negative relationship between corporate board structures and performance observed in three different firm performances is driven by the ownership and lack of monitoring by holding companies. The empirical evidence provided in this study therefore suggests that it would not be sufficient to consider only the

stylized facts to explain firm performance. Hence, it could be concluded that there is no universally applicable corporate governance systems and (Yoshikawa and Phan, 2003) so local laws and local business environment might have stronger influence on the governance system of each country or region (Seifert et al., 2005).

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