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## **Impacts of Corporate Governance on Companies Financial Performance**

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### **Abstract**

The positive correlation between cg data and company size means that the more transparent the company is, the more volatile the stock price will be in the market. This shows that companies' increasing awareness about information transparency compared to the past has created trust in investors, which increased the investment wave in potential companies by domestic and foreign investors (due to limited stockholding volume) during the research period. In addition, when the quality and quantity of information are improved, significant changes in stock prices in the market can be achieved by investors who surf the market and hold stocks for a short period. When a company publishes good information about growth opportunities or future investment potential, this increases its attractiveness to other investors and causes its share price to increase. At this point, wave investors will sell the stock. Therefore, the transparent disclosure of information attracts investors, thereby causing stock price fluctuations in the market. This study aims to investigate the relationship between corporate governance (CG) and financial performance in the case of publicly listed companies. The topic is crucial in understanding how effective governance practices can influence the financial outcomes of companies. The study sheds light on the link between CG practice and firm financial performance. It also provides insights for policymakers and practitioners to improve CG practices. In addition, the study examines the relationship between changes in the CG index and changes in financial performance.

### **Introduction**

The paper's main objective is to determine the relationship between CG performance scores and firm financial performance. Moreover, the methods used to check for possible errors in the regression model are also detailed. These tests are intended to increase the reliability of the research results. Finally, an explanation of the research results is offered. Based on the extant research, there is an argument in favor of more research that examines the impact of CG on financial performance in different contexts and across different types of firms, especially as there is a growing interest in understanding how CG affects financial performance in emerging markets, small- and medium-sized enterprises and other organizations. This study presents data and methods to examine the effect of CG on the financial performance of listed firms. However, research has yet to examine the moderating role of CG in firm innovation capabilities in postpandemic environments, particularly in emerging economies. Consequently, this study aims to investigate the role of CG in enhancing the relationship between capital budgeting, knowledge management, business strategy and innovation capabilities of post pandemic firm

innovation. However, these studies did not find evidence of a relationship between the board of directors' responsibilities and financial performance. Therefore, there is a need for a future study that compares the results of analysis from two different research data sources, including secondary data collected manually and data collected from a direct survey or a qualitative case study or studies. Also, research concerning which aspects of management should be examined would likewise be welcome.

#### Objective of The Study

The study's main objective is to determine the relationship between CG performance scores and financial performance. The study found a positive relationship between transparency disclosure and financial performance and a positive correlation between CG and company size.

#### Hypothesis

*H1.* Firms with more substantial shareholder rights have a positive relationship with firm value and profit.

*H2.* Optimal benefits can only be achieved by respecting the interests of stakeholders and their contribution to the company's long-term success.

To test the hypothesis, our study uses five explanatory variables, including:

1. The CG index variable determined by the four component governance indexes;
2. The component governance index variable related to shareholder rights;
3. The component governance index variable related to stakeholder roles;
4. The component governance index variable related to disclosure and information transparency; and
5. The component governance index variable related to BOD responsibility.

#### Literature review

Numerous studies have been conducted to examine the effects of CG on firm financial performance both formally and informally. Formal CG (Tachizawa and Wong, 2015; Gallego-Álvarez and Pucheta-Martínez, 2020) refers to a firm's organizational structure, including command structure, incentive system, standard operating procedures and written dispute resolution procedures. In contrast, informal CG is characterized by social control and trust (Khatib and Ibrahim Nour, 2021; Chi, 2021). CG has been found to play a crucial role in improving company performance, reducing agency costs and influencing corporate policies. The COVID-19 crisis has highlighted the importance of the board's supervisory role in mitigating risk and postpandemic CG is also essential as companies face ongoing disruptions (Gerged *et al.*, 2021). The link between CG and firm performance has garnered attention from researchers, businesses and policymakers. Several studies have investigated CG's mediating and moderating roles during the pandemic. Corporate governance (CG) refers to the rules, practices and processes by which a company is executed and managed. Good CG ensures that companies operate efficiently and effectively and maximize shareholder value (Alodat *et al.*, 2022). Critical economic arguments for good CG include increased investment and financial performance and reduced agency costs and risks. One important channel through which CG affects economic outcomes is the alignment of incentives between shareholders and managers. This alignment can be achieved through mechanisms such as performance-based pay and

independent directors on boards. Another means is to provide reliable and transparent financial reporting, which can reduce information asymmetries between managers and investors. Despite the clear benefits associated with good CG, there are still challenges in implementing effective governance practices. These challenges include issues such as the concentration of ownership, conflicts of interest and the difficulty of measuring and monitoring governance practices (Hunjra *et al.*, 2021). In sum, good CG is critical for ensuring that companies operate in the best interests of shareholders and maximize their value. According to Farooq *et al.* (2022), companies can achieve better financial performance and can reduce risk by aligning incentives between managers and shareholders and by providing reliable and transparent financial reporting. However, challenges remain in implementing effective governance practices, and endless efforts are needed to ensure that companies are governed as effectively and efficiently as possible. According to Çolak and Öztekin's (2021) study, the impact of COVID-19 on a group of developing countries with poor economies, tight budgets, weak policies and business environments is significant. The COVID-19 pandemic has brought about the need for effective governance practices focusing on risk management, transparency, accountability and ethical behavior. Companies prioritizing these practices will likely emerge more successful and resilient in the post pandemic world.

### Theoretical Underpinning

Several critical CG theories have been developed over the years. Here are brief overviews of some of them:

- *Agency theory* suggests that a principal-agent relationship exists between shareholders (the principal) and management (the agent) and that the agent's interests may not always align with those of the principals. As a result, mechanisms are needed to ensure that managers act in the best interests of shareholders.
- *Stewardship theory* proposes that managers act as stewards of the company and, therefore, have a sense of responsibility to act in the company's and its stakeholders' best interests. This theory emphasizes the importance of trust, cooperation and collaboration between managers and shareholders.
- *Resource dependence theory* suggests that companies depend on external resources (such as capital, labor and raw materials) to operate and that the ability to access these resources is influenced by the company's relationships with external stakeholders. As a result, effective CG is needed to manage these relationships and to ensure that the company has access to the resources it needs to succeed.
- *Transaction cost theory* proposes that companies engage in transactions (such as contracting with suppliers or hiring employees) that incur costs beyond the monetary value of the transaction itself (such as monitoring costs and negotiating costs). Effective CG can minimize these costs by establishing clear transaction rules and procedures.
- *Stakeholder theory* suggests that companies are accountable to a wide range of stakeholders (such as employees, customers, suppliers and the wider community) and that effective CG should consider the interests of these stakeholders and those of shareholders.

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## Implications of The Study

The empirical evidence of this study supports the view that companies with good CG systems – especially in terms of information disclosure and transparency – will positively contribute to companies’ financial performance. Therefore, a good understanding of current transparency is critical for potential investors, stakeholders, policymakers and international organizations who want to know about transparency and wish to derive more value from these dynamic and receptive economies. However, this study only looked at three years, so there will be a particular limitation regarding the research time frame of disclosure concerning the companies. Nevertheless, this limitation will be overcome in the future because, for international integration, transparent disclosure of company information needs to become a more common practice for listed companies and public companies in India and this is necessary for sustainable development. Furthermore, good corporate transparency practices must be improved to build a better business environment for attracting domestic and foreign investors and to build trust, honesty and ethical values in the marketplace. Investors are the ones who can directly or indirectly pressurize companies to strictly and voluntarily implement transparent information disclosure through share price mechanisms. Accordingly, in addition to reviewing company performance based on financial statements, investors need to base their scores on the quality of CG practices concerning each listed company with a view to limiting investment risks.

## Limitations

Finally, because the goal of the study only considers a one-way relationship of the impact of the CG index on financial performance, the study – due to data limitations – does not thoroughly address the two-way relationship as do previous overseas studies. Therefore, the following research direction can use a more extended period to examine the spillover effect between the CG index and financial performance. In addition, further research needs to review the two-way relationship between the CG index and the CG, as well as the change in the CG practice quality index and CG performance change. Finally, there is also space for a study to compare analysis results from two different research data sources, including manually collected secondary data and data collected from direct surveys.

## Conclusions

Policymakers need to develop a set of criteria for assessing CG practices. They also need to promulgate specific regulations for mandatory and voluntary information disclosure and designate a competent authority to certify the transparency of company information. The study also suggests that companies should develop CG regulations and focus on regulations relating to the business culture or ethics, as well as implementing a system to ensure equal treatment among shareholders. The study found that good CG practices can positively contribute to a company’s financial performance, which is crucial for investors to evaluate the quality of CG practices for each listed company so that investment risks can be limited. Research results also show that companies with a good CG system, which are specifically responsible for stakeholders such as employees, the environment and products and concurrently offer open and transparent information, will help increase financial performance. Each company – not only

listed companies but also small- and medium-sized companies – must develop CG regulations to suit its current situation and should harmonize interests between the company and its stakeholders. In addition, companies need to make regulations on business culture and ethics. In particular, companies need to make regulations concerning equal treatment of shareholders (shown in the table) and should earnestly implement them. This should be so as the lack of such regulations creates a potential source of conflict of interest and conflict of power between major shareholders and minority groups of shareholders, as outlined by agency theory, and it is also a fact that some joint stock companies in India went bankrupt because of this conflict. Although this proposal is inconsistent with the research results because these results show that there is equal treatment of shareholders of listed companies in India, the trend of governance – as attested by international practices in developed countries – is to further improve the equal treatment of shareholders.

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