Corporate Governance

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A good corporate governance relies on the existence of some trust relationships between the entity, the investors, and other interested parties.

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1. Introduction

The application of principles, rules, and practices that are specific to a good corporate governance has some determinant benefits such as an increased credibility of financial and non-financial reporting to the investors, the ease of access to capital and lower financing costs, the identification and valorization of all the competitive opportunities, the implementation of an adequate management control that ensures an efficient use of resources, and the adequate control of risks that could affect the sustainable development of the entities [1][2][3][4]. For this reason, the impact of corporate governance over financial performance has been questioned in different contexts. The basis of a good corporate governance is influenced by the management behavior, which plays a part in the accomplishment or non-accomplishment of the objectives of the entity [5][6][7]. In the given context, ensuring the quality of corporate governance imposes responsibility, correctness, transparency, and qualitative relationships among shareholders, board of directors, management, and employees [8][9][10][11]. In turn, these aspects define the authority and the responsibility of the ones that are part of the governance, by supplying sustainable value to all interested parties, as well as the basis for improving financial performance [12][13].

Due to its significant impact on the reporting of financial performance, it is meaningful to identify implementation solutions to ensure a pro-active approach in the field of risk management [14][15][16]. In ensuring information transparency, as required by an appropriate financial reporting system [17][18][19][20], it is necessary to adapt corporate governance practices to the particularities of each reporting entity.

Despite the fact that there are many initiatives to stimulate good corporate governance for economic growth, there are still gaps in developing countries. These can be caused by multiple factors, such as financial literacy [21], the level of savings [22], the level of corruption [23], or other external factors. However, most of the time, good corporate governance is a strategy conceived from within an entity, central to which are the board of directors and the management structure. In developing countries, corporate governance has become a widely discussed topic, being considered a key point for economic development [24][25][26][27]. Even though it is considered an important center of interest for in-depth economic and financial studies, we find that corporate governance mechanisms and practices are less developed in these countries [27]. Thus, the topic of corporate governance in developing or emerging market countries is still insufficiently debated in the literature, leaving an important gap that can be explored by conducting empirical or comparative studies. Herein highlights the importance of corporate governance mechanisms over financial performance in an emerging market from Europe.

2. The Impact of Corporate Governance Mechanism over Financial Performance

The economic, social, and environmental challenges faced by societies determined the entities with an economic purpose to adopt measures and behaviors that would diminish the impact of the economic activity on these challenges. For this, the theory of legitimacy was developed in order to guide the process of disclosing economic, social, and environmental aspects [28]. These disclosures may affect the financial performance and value of the reporting entities.

Over time, many research and studies were carried, through which a series of relationships and contributions of corporate governance and sustainability were elucidated. The most relevant research focused on: the impact upon the increase of financial performance through the affiliation of entities to a group [29][30]; the adequate motivation and monitoring of managers with subsequent influence in share prices [31][32]; the determination of managers to apply investment policies that lead to the maximum value of the entities [33][34]; the increase of the performance and market value of entities [35][36][37][38][39][40]; the relationship between performance, structure, and stock holdings among the members of the board [41][42], and the increasing competition to attract investors and the economic performance of entities [43][44].

The relationship between good corporate governance and the financial performance of a corporation is a topic well studied, especially in the last 20 years, due to the notorious scandals of large corporations [45]. Big challenges, driven by the globalization phenomenon and change, lead to a rethinking of conceptualizing the responsibilities of an entity [46]. Over time, corporate governance systems have been affected by the vulnerabilities of internal control which caused failures to anticipate or notice the materialization of some risks, which include a loss of trust on behalf of investors in the business [47][48][49]. Relevant in this sense are the big financial scandals, which followed the bankruptcy of some big corporations such as Enron, WorldCom, Global Crossing, Arthur Andersen, and Parmalat. In the given circumstances, on an international, European, and national level, the authorities have taken some legislative and regulatory measures in order to create the necessary premises for re-building investors' confidence in the quality of financial and non-financial reports. One of these actions targets the enhancement of social performance through transparency and credibility in the image of the reporting entity. Eloquent proof is given by ensuring the correspondence between the actual financial performance and the represented reality. Besides the measures taken by authorities and professional organisms over time, a series of studies and research were undertaken that focused on the analysis of different dimensions of the relationship between corporate governance and global performance of an entity.

In the past decades, many researchers have been experimenting with new concepts, theories, or models to facilitate the understanding of the challenges of the business environment. One of the most notorious theories is the "stakeholder theory" [50] which suggests that stakeholder relationship analysis can lead to a better understanding of such challenges. Moreover, stakeholder interests are extremely important when considering the performance of an entity of its value. With reference to the analyzed factors and dimensions, the obtained results were different from a certain approached circumstance, situation, or stage to another. Hence, some studies highlighted the impact of the corporate governance mechanisms upon the quality of financial information, financial performance, share prices, or investment policies.

Corporate governance has been shown to increase transparency in financial reporting [51]. Multiple studies that examine the influence of corporate governance on financial performance [52][53][54][55][56] or the influence of compliance with corporate governance codes on financial performance—through the apply or explain principle [57][58][59]—show that the existence of corporate governance practices/mechanisms positively influence financial performance.

Moreover, the research on this topic has highlighted the diversity of the environments in which the entities function, a decisive factor that has stimulated the development of some corporate governance systems which are continuously evolving under legal, economic, financial, accounting and social points of view, including from one country to another [52].

According to both international and national financial reporting frameworks, the dedicated objective of financial reporting is the presentation of the financial position and financial performance, including cash flows and changes in equity. In this context, the financial performance is represented through accounting results, respectively, profit or loss and comprehensive income. In comparison with the profit or loss, determined as a difference between the total of revenues and expenses—out of which the components of other comprehensive income are excluded—the comprehensive income has a larger area that targets the modification of equity over a reporting period.

Achieving the global performance that could provide the foundation of a sustainable economic increase requires a complex approach of corporate governance, in which the identification of some adequate mechanisms for treating the risks generated by the divergent interests of the different interested parties is primordial [60][61]. Considering stakeholder and corporate governance perspectives, the board of directors is a key factor in increasing shareholder value, but also in protecting shareholders' interests. Thus, studying the board effectiveness has attracted a lot of research attention. A recent study analyzed the impact of board composition on sustainable performance on companies located in Tunisia. The results show that board effectiveness positively influences sustainability performance, expressed through economic, social and environmental performance [62]. Similar results were obtained by Chams and Garcia-Blandon [63] when analyzing a sample of 478 multinational companies. Additionally, gender diversity seems to increase sustainability disclosure and performance [64]. In contrast, a study on state-owned companies from Europe shows that board composition does not impact sustainability disclosure, but rather the industry in which it is activated [65].

Among the main responsibilities of the governance council, of particular relevance are the ones referring to management monitoring and guiding the entities towards financial and social performance through adequate strategies focused on value added. In the given context, in other studies it is shown that the most important element of corporate structures is the board of directors (BoD). The structure of BoD, the decision-making processes on which it is based, as well as the way in which its committees continuously improve corporate governance, have a major influence over the quality of the reported information. Moreover, establishing a corresponding vision at the highest organizational level of an entity is necessary for insuring a trustworthy climate [66].

The research carried on this topic has shown that in the structure of the BoD it is important to have a higher proportion of non-executive members compared to executive ones.

A non-executive or independent member of BoD is defined as a person who does not have executive responsibilities and who is not affiliated with the entity [56]. Theoretically, independent members are objective in the process of monitoring managers and thus ensure a better protection of the stakeholders' interests. The supporters of this theory have proven that a higher number of non-executive members improve the relationship between the investment opportunities of an entity and its performance [67][68][69].

In other studies, the existence of a positive relationship between non-executive members and entities' performance was demonstrated by improving the performance, the credit rating, the market value of the entity, and by other similar effects. Relevant to this is the research undertaken by O'Sullivan [70], who examined a sample of 402 British entities and concluded that the presence of non-executive members in BoD encourages internal audit which, in turn, contributes to the better monitoring of these structures of corporate governance. Additionally, under such circumstances the costs of agency are smaller. This conclusion was also reached by Fabrizi et al. [71] who proved that a higher proportion of independent members in BoD is correlated with a better performance of entities. On the contrary, the research carried by Weir and Laing [72] argued for a negative relationship between the representation of independent members and the performance of an entity. Previous research suggested that there was no correlation between the proportion of non-executive, independent members in the board of directors and the entity's financial results [42][67]. Moreover, based on the performed studies, Chang et al. [31] concluded that the interested parties are not satisfied by the way independent members represent their interests.

An essential characteristic of a BoD is the size of its structure. Some research has shown that entities with more directors can attract important resources in an easier manner and reduce the exposure to inherent risks [56]. Hence, in this type of situation, the coordination and the communication in the process of decision making is more difficult to accomplish, which in turn affects the way in which the objectives of an entity and the interested parties are achieved. By adding a new member to the BoD, the relationship between diversity and coordination determines a potential opportunity cost.

Some studies reached a conclusion that the optimal number of BoD members is between seven and eight. This recommendation depends on a series of factors specific to each entity, such as the industry in which the entity operates. Generally, credit institutions tend to have more BoD members than productive entities [67].

Previous research on this topic yielded different results concerning the impact that BoD size has on the performance of an entity. Hence, Lloret [73] identified a positive relationship between the BoD size and performance, while the results obtained by [74] are not conclusive.

Even though coordination is more difficult in the case of more BoD members, diversity, experience, and expertise for improving financial performance are supplied to the entities.

There are opinions that the conflicts between managers and shareholders are more easily overcome provided that the BoD members also have a role as shareholders in the considered entities. Moreover, the geographical and political aspects may determine the influence of corporate governance mechanism over financial performance or firm value. For example, many studies show big differences between European companies and U.S. companies. According to a study conducted by Lozano et al. [75], the ownership of European companies is highly concentrated, while the ownership of U.S. companies is more dispersed. The ownership structure can influence management decisions. In European companies, the main owner has effective control over the company's decision, thus trying to increase the firm value or the financial performance. We expect that the percent of the shares owned by BoD members is higher in European countries, like Romania. From this perspective, it is shown that if the BoD members are also shareholders, they are interested in the proper functioning of the entity, and are less motivated to behave negatively towards other shareholders [76]. Thus, conflicts between managers and shareholders can be decreased. On the contrary, other research showed that there was no correlation between the performance of an entity and the fact that the BoD members were also shareholders. Some other studies [61][67][71] prove that when the BoD members are also shareholders, the entity's performance increases only by 5% after which it decreases, while the number of shares increases with 25% and re-increases slowly at higher levels of ownership. Moreover, the authors support the theory according to which managers tend to allocate resources to entities in their own interest.

As in the case of the other variables, there are several approaches to the relationships that exist between the BoD chairman–CEO duality and the performance of an entity. The CEO is the person that provides the top management of an entity. Many researchers have concluded that a combination of the BoD Chairman and CEO positions is not optimal for the leadership structure of an entity. This perspective shows that through the concentration of the decision authority, independence is limited and efficiency in monitoring management is reduced [36][49][77][78]. Moreover, a study conducted by Chen et al. [79] shows that the duality of the CEO/chairman does not cause financial distress.

Other research showed no significant relationship from this perspective. Moreover, it was highlighted that under the circumstance of one person holding two positions, the entity will have a unitary and stronger leadership. Moreover, the elimination of the potential CEO–BoD chairman conflict will help avoid the confusion generated when an entity is publicly represented by two persons that could have different perspectives [67][70].

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