

# The Impact of Corporate Governance on Company's Performance through Non-financial Indicators

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## Abstract

*The changes from the past years, both as a result of globalization and corporate failures, have influenced companies to serve the interest of all users, so the interest in non-financial information is growing more and more. The lack of non-financial information in recent corporate reporting is a disadvantage for stakeholders because information such as managerial quality, company reputation, risks and opportunities, the company's social and environmental concerns are not presented in the financial reporting. The purpose of this study is to identify the main non-financial indicators that lead to the improvement of corporate governance by increasing the performance of companies in the context of globalization.*

**Key words:** corporate governance, company performance, stakeholders, non-financial indicators, financial indicators.

**J.E.L. classification:** G30, M40, M41

## 1. Introduction

Corporate governance, as a component part of modern management, has become a key tool for achieving performance goals and reducing company risks. In the current era of knowledge, the economic environment is constantly changing, and the information is moving at astonishing speed.

The research has reconfirmed that the proper governance of an entity can only be achieved by knowing and applying corporate governance principles, rules and practices with responsibility. According to corporate governance theories, if they are well known, understood and applied, they can increase the credibility of entities, easier access to capital markets, lower capital costs, efficient use of resources, sustainable business development and, implicitly, a healthy economic environment. In order to achieve the public interest, new challenges and trends, it is essential for management and control systems to reconfigure the objectives in which the achievement of global performance has implications for social responsibility and environmental protection.

In this context, many companies have begun to understand how stakeholders want them to measure, manage and take into account the full range of impacts of their work on society and the environment. Thus, it is considered that the best way to ensure financial success in the future is to expand the overlap between business interests and the interests of society and the environment. Transparency and responsibility, together with a close working relationship with stakeholders, will enhance business, serve the interests of shareholders, and create a better world. This type of report must therefore reflect the growing commitment to work with the workforce, business partners, government agencies and environmental and community stakeholders.

The present study aims to be a theoretical and empirical one on the issue of corporate governance in the context of globalization. The first part includes the review of the specialized literature, bringing to discussion the elements regarding the current state of knowledge related to the principles of governance, as well as the theoretical approaches regarding the evolution over time of this issue. The second part, research methodology, brings to the forefront, with the help of specific methods, a practical study that identifies the main non-financial indicators that lead to

good corporate governance. The third part contains a series of conclusions based on the results of the analyzed data, indicating a general overview of the empirical stage, while bringing to the attention of the reader current, relevant and comparable information on corporate governance from different points of view.

The last part of the paper is represented by conclusions, the latter being revealed by synthesizing the information gathered on the topic under investigation.

## 2. Literature review

Like any highly paradigmatic concept, in its evolution, corporate governance has had connotations specific to each stage of its development, in which the environment, level of development or specific culture of each country, economy or entity has impressed. An intrinsic component of a modern economy, specialized literature assigns a wide variety of connotations to corporate governance.

Corporate Governance (GC) defines a set of principles, rules and control mechanisms to protect and harmonize the interests of all categories of actors in the economic plan. We remember that the interests that develop within corporations are often contradictory. In a particular approach, corporations are very complex social organization systems, with the status of legal persons, having the legal authority to issue or transfer shares and bonds. According to the Oxford Dictionary, a corporation is a company or group of companies authorized to work together as one entity (Oxford Dictionaries, 2014).

Another approach we encounter at the World Bank defines corporate governance as a combination of voluntary laws, regulations and codes of conduct, to facilitate access to funding sources, low capital costs, better performance, and favourable treatment for all stakeholders. Thus, countries that have collaborative relations with the World Bank have initiated reform projects and regulations for corporate governance (The World Bank Group, 2012).

Diminishing the conflict between the managers of an entity and its shareholders leads to a significant increase in profit (Webb, 2008). Companies with good financial performance, such as an increasing return on Equity or a high Asset Turnover Ratio, can obtain loans at a lower cost reduced (Hu et al., 2011). They get easier funding because they are able to pay their debts on time (Shan & Xu, 2012), (Abor, 2007).

At international level, corporate governance is influenced by globalization, a complex process that manifests itself in all areas of society. The phenomenon of globalization encompasses many aspects of economic, social, cultural and political life. In a general sense, this term describes processes, ideologies, and strategies by which a change in a globe determines global changes affecting other parts of the globe (Horomne, 2015b). Economic downturn, globalization is associated with the free movement of capital, goods and services, and market liberalization, respectively. Due to technical progress, corporate governance codes face new challenges such as internationalization of production, rapid information transfer, technological change, the need to implement international standards to regulate exchange market activity, including the recurrent mobility of human capital. In the context of a globalized market, the main issues faced by corporations relate to the requirement for relevant and timely information, monitoring costs, the management relationship - shareholders and the protection of all stakeholders.

The description and understanding in a more complex manner of the concept of corporate governance was possible through the emergence and development of some theories. Among these, we mention:

*The agency theory* is based on the existing conflict between the entity's main shareholders, that is, its owners and managers, agencies that run the company's business. There are also some critical views on this theory that the phenomenon is too "sub-contextualized" to compare and explain the diversity of corporate governance arrangements present in different organizational structures (Dedman & Filatotchev, 2008).

*Stewardship Theory* suggests that managers administer companies with responsibility, acting to obtain the best results, and their interests are not in contradiction with those of shareholders. For this reason, the additional control measures applied to managers are unnecessary and limit their

freedom of deduction. According to management theory, the agents / managers act on the users, while the administrators act for the benefit of all stakeholders (Pirie & McCuddy, 2007).

*Resource dependence theory* - dependence on some "critical" and important resources influences the actions of organizations and therefore their decisions and actions can be explained in conjunction with each particular situation of addiction (Nienhüser, 2008).

*The theory of strategy formulation* deals with the implementation of creative strategies, to make competitive advantages on the capital market (Brown, 2007).

*Stakeholders Theory* promotes the principle of business ethics, arguing that an organization must serve the interests of all stakeholders, on the principle of equality, or on the importance they have within the entity.

*The theory of behavioural approach in opposition to regulation*, also called human theories, takes into account the human dimension of work; behavioural approach is about understanding human behaviour at work, such as motivation and expectations.

All of these theories help us understand the concept of corporate governance, namely how an organization adopts the decisions necessary to achieve its objectives and equitably distributes rights and responsibilities among all stakeholders.

### **3. Research methodology**

Any scientific approach begins by presenting both the research area and the research object. Thus, with regard to the present paper, the location of the research area can be included in the corporate governance research sphere, in terms of company reporting, namely the identification of the key performance indicators in the annual reports of companies quoted on the capital market.

The choice of the research methods used is closely related to the proposed objectives, so the research methods and tools used throughout the thesis are generally based on a deductive approach, from general to the particular, mainly used at the level of the theoretical / qualitative research. By methodological aspect, the research is mixed, theoretical - applicative, the researched field includes both a qualitative and quantitative approach. The qualitative approach consists of the scientific documentation, in order to deepen the information held so far on the performance concept / performance indicators from the point of view of non-financial reporting, the presentation of the benefits of non-financial indicators for an organization, and the scope of quantitative analysis aims at identifying the most important key performance indicators presented by reputable companies in their annual reports. The selected sample for qualitative research consists of a total of 35 companies listed on different European capital markets.

This research analyzes the extent to which key performance indicators are published in the annual report by the companies surveyed in the quantitative study and presentation of the most important indicators included in their annual reports from 2015-2017.

### **4. Analysis and Results**

Companies, especially listed companies, provide stakeholder information with an overview of business performance, the internet being the key tool in the process of disclosing this information (Asbaugh et al., 1999). In general terms, disclosure of information to stakeholders is strongly influenced by several theories, including the principles of agency theory, which have explained various factors that influence the way in which information is presented, the factors that lead to the dissemination of information result from a symbiosis between the complexity of the business and the needs of the stakeholders. Thus, each of these theories finds its foundation through the relationship established between the company and the stakeholders.

The study card presents the most important non-financial indicators reported between 2015 - 2017 by the companies analyzed, which publish annual reports according to the international reporting framework. Thus, the reports published by these companies were analyzed in order to identify the most important key non-financial performance indicators published through the annual reports, the results being presented in Table 1.

Table no 1 Non-financial performance indicators

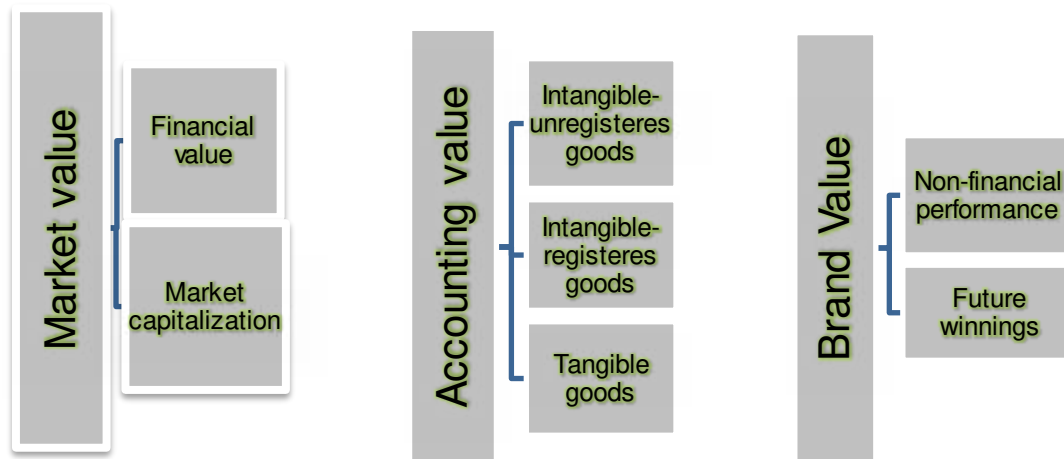
<b>1. Objective non-financial indicators</b>		
<i>Focus on organizational activities</i>	<i>Focus on employees</i>	<i>Focus on clients</i>
<ul style="list-style-type: none"> <li>o Production volume</li> <li>o Productivity of work</li> <li>o Productivity / equipment</li> <li>o Degree of use of the material</li> <li>o The efficiency of the interior organization</li> <li>o The duration of the production cycle</li> <li>o Inventory level</li> <li>o Number of defective products</li> <li>o Number of newly launched products</li> <li>o Efficiency of new product design</li> </ul>	<ul style="list-style-type: none"> <li>o Employee satisfaction</li> <li>o Employee competence level</li> <li>o Employee empowerment</li> <li>o Level of security measures</li> <li>o Level of employee training</li> <li>o Absence degree o Market share</li> </ul>	<ul style="list-style-type: none"> <li>o Time required to meet customer orders</li> <li>o Delivery performance</li> <li>o Time to respond to customer problems</li> <li>o Flexibility of the product</li> <li>o Customer satisfaction</li> <li>o The degree of customer appeal</li> <li>o Client retention degree</li> </ul>
<b>2. Subjective non-financial indicators</b>		
<ul style="list-style-type: none"> <li>o Long-term business outlook</li> <li>o Ability to gain new skills / knowledge in an efficient way</li> <li>o The desire to share knowledge in the field of organization</li> <li>o Degree of cooperation with the other departments of the organization</li> <li>o The mood / morale of the employees</li> <li>o Management / leadership style</li> <li>o Loyalty to the company</li> </ul>		

Source: Author's compilation

After analyzing the annual reports, it can be argued that there is a direct correlation between market value, book value and brand value within an organization, in the sense of creating value. Regarding the relationship between investors and the organization, market value is the most obvious focus. Also, the constitutive elements of market value, relationship with brand value and accounting value are also presented. Figure no. 1 below serves to illustrate this. The value of the brand is long-term, considered as an element of market value. While long-term gains will represent a significant proportion, these potential gains will be subject to less controllable influences. These influences can be categorized as non-financial factors such as human capital, customer relationships, partnerships, corporate governance, and so on.

Book value is a reflection of the value of companies' assets. It includes both tangible assets and intangible assets. Accounting recognizes the importance of several classes of intangible assets that are included in the company's balance sheets, which in turn influences investor ratings. However, some classes of intangible assets are not recognized and may influence investors' perception of the degree to which companies can convince investors of their materiality. The communication process can have an impact on market value and implicitly on financial performance.

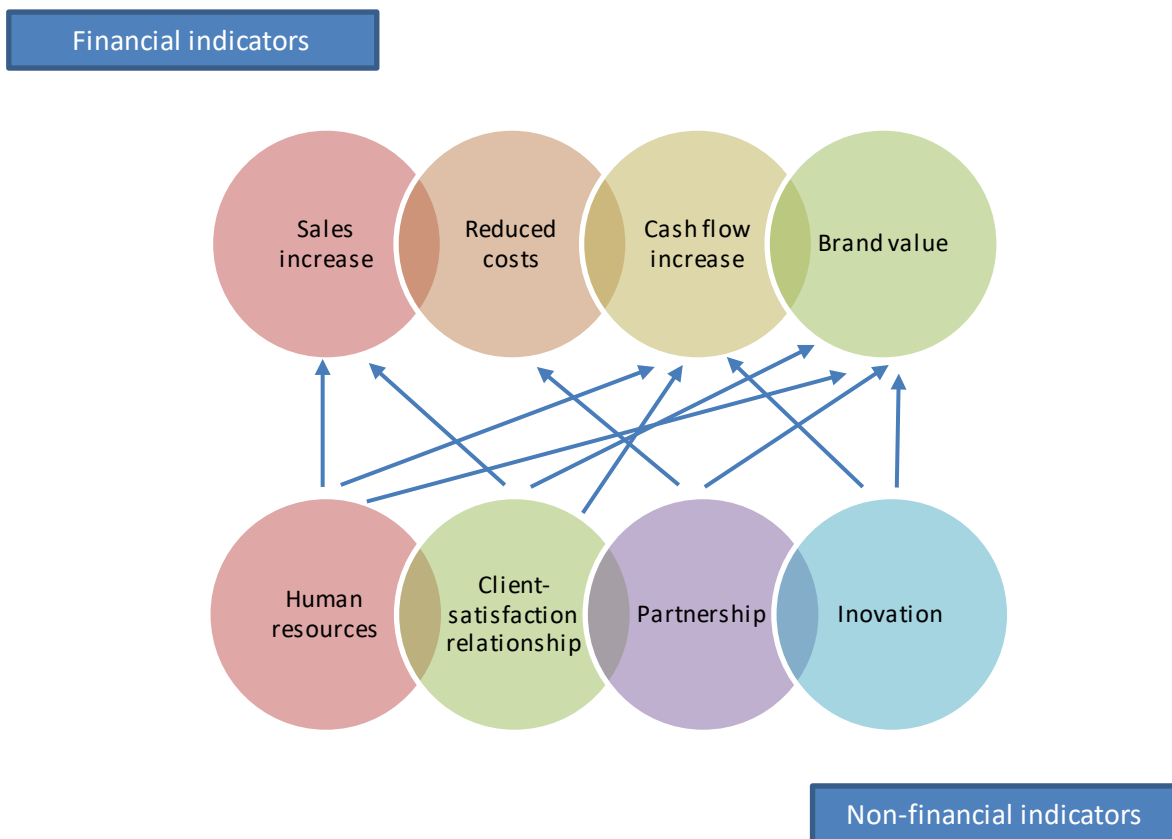
Figure no. 1 Correlation between market value - book value and brand value within a company



Source: Author's compilation

In order to present the impact of corporate governance on the company's financial performance through non-financial indicators, the effect of each non-financial indicator identified as a result of the analysis is described below, as can be seen in the figure below:

Figure no. 2 Impact of non-financial indicators on financial indicators



Source: Author's compilation

The relationship with customers – company's attention should be given primarily to customers, their needs, and their expectations. This area is important to the organization because customers are the ones who pay for its products and this is its source of income. It is very important for the company to know their expectations and expectations, as well as to translate these requirements

into its products and services that can be marketed. In this respect, the effect of this non-financial indicator is on the volume of sales, cash-flow and implicitly in the value of the company's brand.

Human resources - focusing on employee satisfaction as well as recognizing their value by rewarding them, motivating them, generating their commitment to the organization, and ending up to use their knowledge and skills for the benefit of the organization will have an effect on the figure business, cash flow growth and, implicitly, the company's brand.

Partnership - one aspect of the company's public image is important. Improving the way the general public sees the company can mean increasing turnover and stronger relationships with the community. Potential objectives include keeping a professional image and a positive presence in the media.

Innovation - it is an important factor of social and economic growth, the nature of innovation, its role and its determinants are beginning to enjoy a wider recognition with a long-term effect on the increase in cash flow and implicitly on the company brand.

## 5. Conclusions

In the current dynamic and very competitive environment the best road for companies to create a successful organisational environment is to try and define the elements which will lead to this road. Their principal purpose would be the determination of performance indicators that will conduct to high results. External environment requires companies to be capable to adapt to a large competition scale, international, and be able to compete in the same time from multiple perspectives, such as price, quality, customer relationships and flexibility. High-performance companies are being described by specialty publications the companies where high productivity, customers satisfaction, exceptional financial results, innovation and leadership skills are seen. Through an overview of the literature, however, it is possible to identify the specific terms of each category: sustainable financial development, long-term orientation, obtaining exceptional results, which refers strictly to the company as an entity and its results. Thus, performance measurement is a fundamental part of any organization, whether it is part of a public or private sector. This paper presents the most important non-financial indicators for measuring performance through an analysis of annual reports published by companies that use corporate governance management tools. In the context of the new performance approach, non-financial indicators such as customer satisfaction, employee fluctuation, or product quality are particularly relevant to determining the value of a company.

Consequently, the major objective of this scientific approach will be to answer "What are the key non-financial indicators that can measure the effects of corporate governance on company performance?" Moreover, empirical research will contribute to the completion of existing literature through the implementation of significant national and international surveys, thus providing a complex and useful tool for analyzing and improving corporate governance models and financial reporting.

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