

# The Financial Performance Impacted by Corporate Governance

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## Abstract

*Corporate governance is the notion that has become more and more contoured in today's corporate world, so addressing the relationship between the quality of the system or the process of corporate governance and the size of the performance, no matter how it materializes, brings it back to the forefront. financial and accounting information. Both the impact of the informational asymmetries and the way in which the entities are managed and controlled on the performance are highlighted using financial and/or non-financial indicators that can be determined considering the different hypotheses and circumstances of the activity carried out by to an entity. Starting from these desires, the objective of the research carried out is oriented towards identifying the methods by which the corporate governance contributes to the improvement of the financial performance of the companies.*

**Key words:** Corporate governance, financial performance, market value

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

## 1. Introduction

The concept of financial performance is frequently approached within the framework of corporate governance, being closely related to the achievement of the objectives pursued by both the entity and the system through which it is managed. This connection is based on the idea that the existence of adequate control mechanisms and well-designed and efficiently implemented corporate governance structures lead to an increased level of profitability. In turn, these performances can be the guarantee of a high level of financial return of the capital and, implicitly, an increased stock market value of the securities held by the owners of the capital.

Therefore, the link between corporate governance and financial performance is extremely complex both theoretically and empirically, as this is not just a "means of survival" and continuity, it is in fact a "strategy to prosper" through which the entities attract investments and increase their economic performance and competitiveness (Feleagă et al., 2011).

Numerous research and studies have shown that well-governed entities perform better compared to those where corporate governance is not adequate. Relevant in this regard are the empirical research that has shown that ensuring good corporate governance influences the performance and market value, Ball et al (2001), Bushman & Smith, Klapper& Love (2006), Abidin et al. (2009).

The research paper has a theoretical as well as an empirical approach, which analyzes the impact of corporate governance mechanisms on the financial performance of companies. The paper is structured in three sections, in the first section presented a review of the literature, being presented the elements that identify and present the link between corporate governance and financial performance. In the second section the research methodology is presented, which brings to the fore the methods by which the main elements of the corporate governance mechanism that influence the financial performance of companies are identified. The last section presents the conclusions based on the results of the analyzed data, bringing to the reader current, relevant and comparable information on corporate governance as a factor contributing to the improvement of financial performance.

## 2. Literature review

In the specialized literature and the norms regarding accounting, governance and management, the concept defined by the phrase "global performance" is frequently used. Like the analyzed concepts it has different approaches and, implicitly, dimensions. One of the most relevant approaches is the one formulated by Reynaud (2003), with the view that the global performance is represented by the performance of an entity viewed from three perspectives. The first focuses on the economic performance, the second on the social one, and the third refers to the performance that addresses the environmental issues. The three dimensions of performance are expressed through the financial results obtained by the entity; thus, it highlights a new side of it - "financial performance". In the context shown are surprised both the actions taken to maximize the value of the entity or those generically focused on value creation, as well as actions aimed at protecting employees and the environment.

Viewed from the perspective of the dimensions outlined within the theories specific to corporate governance, in the analyzed works were highlighted different relationships and assumptions of financial performance in the specific context of the management and control system of an entity. On the one hand, the effects of the system or the different components on the performance were instrumented, and on the other hand the performance imprints on the quality of this system. In this sense, the works that surprise the assurance of good corporate governance have effects on increasing the performance and market value of the entities (Klapper&Love, 2012), identifying the relationship between the growth of the economic performance and the competitiveness of the entities through the application of the corporate governance system (Feleagă et al., 2011) and the ways in which corporate governance contributes to improving the quality of accounting information and determining the real size of financial performance.

Corporate governance can have a significant impact on the financial performance of the entity through the capital structure. This impact on performance can be exemplified on the one hand by measuring the performance starting from the degree of capital concentration, a large dispersion or dilution of capital between many shareholders determines the consolidation of the manager's position and, implicitly, their rooting. In this case, the owners of capital cannot or do not want from economic reasons to maintain the control cost, respectively the agency cost of the managers (Shleifer&Vishny, 1989), and on the other hand by researching the impact of the control that different shareholders have on the performance. Compared to the first approach, the concentration of capital in this situation is high, as a rule it is owned by a small number of shareholders, an aspect that allows the monitoring and control of the managers more intensely. As a result, the agency costs generated by potential conflicts of interest are greatly reduced, and in this way the impact of corporate governance is reflected in the improvement of the performance of the entities in these situations (Shleifer&Vishny, 1997).

Another approach found in the specialty literature concerns the relationship between diversification, performance and corporate governance. In this perspective, diversification plays an important role in the elaboration and implementation of the corporate strategy. According to the investment theory, diversification reduces the risk of an investment without affecting the expected income. In this context, diversification contributes to improving the competitive advantage either by involving different business entities with the objective of creating added value for shareholders, or by integrating a new business within an existing one.

Another study based on the idea that in the presence of certain corporate governance structures, the impact of the diversification strategy is focused on one of the two extreme sides and can have positive or negative effects, highlighted the following aspects: agency conflicts are one of the main causes of declining value of the entity as a result of diversification; the corporate governance structures determine the entity's orientation towards diversification, as a consequence of reducing the value; agency conflicts are the motivation for maintaining the diversification strategy, even if the effects of diminishing the value of the entity are very obvious (Ileana, 2008).

All these approaches help us to understand the concept of corporate governance, respectively how an organization makes the decisions necessary to achieve its objectives and respectively their achievement through financial performance.

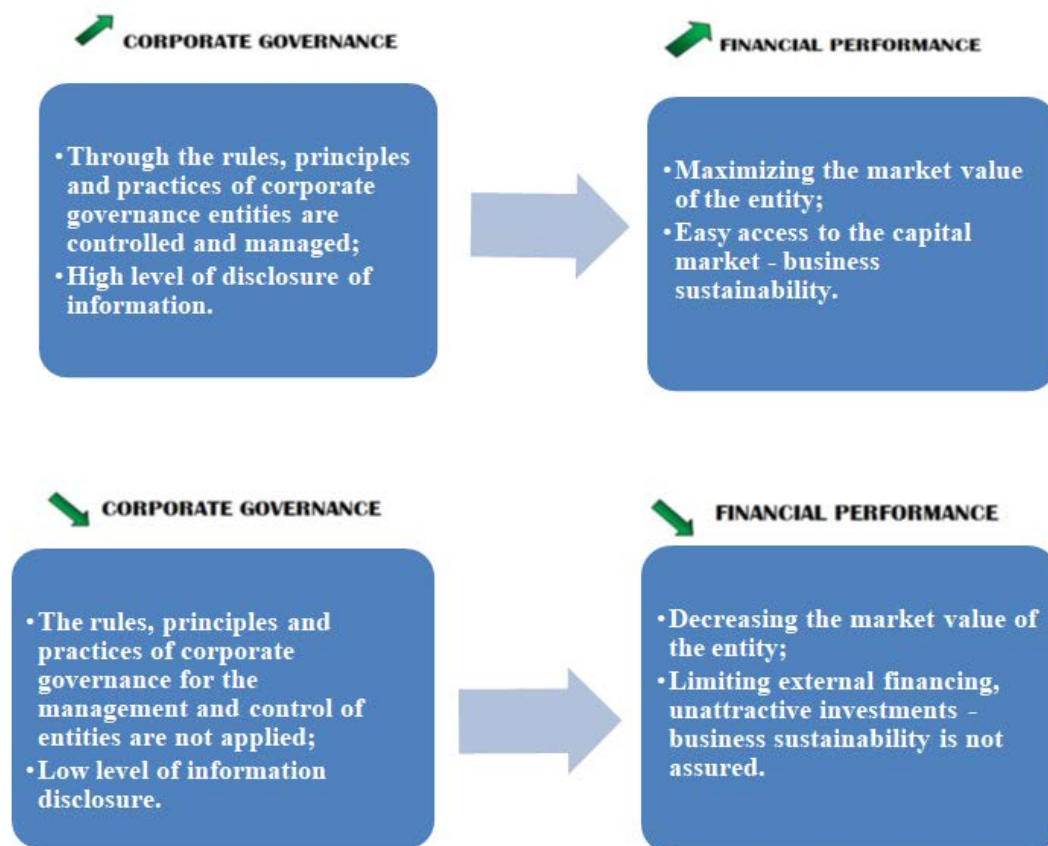
### 3. Research methodology

Regarding the present paper, the positioning of the research area can be framed within the scope of corporate governance research, namely the identification of the relationship between the mechanisms of corporate governance and the financial performance of the companies listed on the capital market. The choice of the research methods used is closely related to the proposed objectives, thus, the research methods and tools used throughout the paper are generally based on a deductive approach, from general to particular, mainly used at the level of theoretical / qualitative research. From a methodological point of view, the research includes a qualitative approach. The qualitative approach consisted of scientific documentation, in order to deepen the information held so far on the concepts of corporate governance and financial performance, by identifying the benefits brought by the financial indicators for an organization.

### 4. Analysis and Results

Synthesizing the most important aspects of the relationship between governance and performance, it is apparent that, by applying clearly defined and applied corporate governance principles, rules and practices, the following aims: increasing the credibility of entities in relation to investors by providing useful information; reducing the cost of capital; more efficient use of the increasingly limited resources available to entities through the implementation of adequate management control; a sustainable and sustainable development of entities in which risk control can play an essential role in ensuring business continuity; an appropriate competitive environment and other such effects. In Figure 1, the relationship between the quality of the management system and the size of the financial performance is presented.

Figure no. 1. The quality of corporate governance vs. the level of financial performance



Source: Own processing

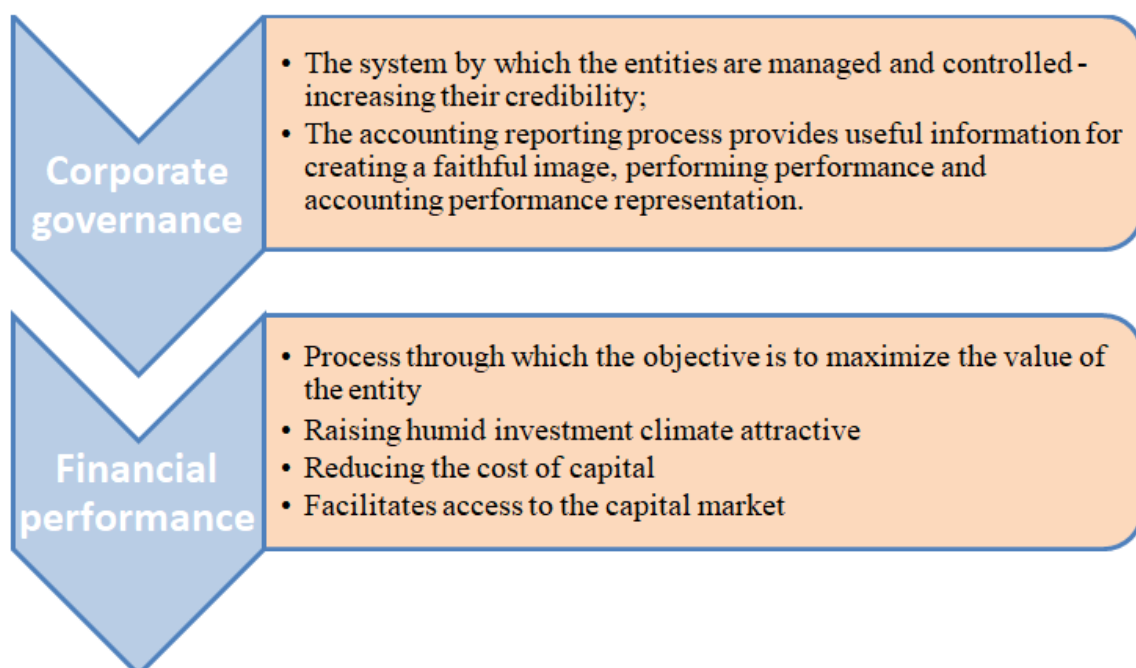
The aspects highlighted emphasize that between the transparency of information and the quality of the corporate governance system, as well as between it and the size of the financial performance, there is a causal and interdependent link. As a result, a high level of transparency is associated with high quality corporate governance practices, which in turn are the guarantee of good transparency and credibility of the information provided by the entities to which it applies. Moreover, good corporate governance can have positive effects on the size of financial performance, which in turn is reflected in maximizing the entity's market value for shareholders and other stakeholders.

While the achievement of the above objectives implies good corporate governance, the opposite pole is located the weak corporate governance, which is directly reflected in the size of the performance of the entities concerned and conversely The relationship between the size of the financial performance and the quality of the corporate governance system is mediated by ensuring the usefulness of accounting information.

Therefore, the research carried out emphasized the need and importance of having reliable information in order to reproduce the faithful image of the represented performance, but also the relationship of dependence between it and the existing level of governance. In the context shown, the objectives pursued by the accounting system must be the integration and synchronization with those of the management and control system, as well as with the risk management system of the entity concerned, and in this way credibility, relevance and comparability can be ensured. the accounting information provided by the elaborated reports.

The graphical illustration of the relationship between corporate governance and the performance of entities in the context of ensuring the usefulness of financial accounting information can be reflected as in Figure 2.

*Figure no. 2: The relationship between corporate governance and economic performance*



*Source: Own projection*

As a result of the research carried out it can be said that, the financial performance of an entity bears the imprint of the performance of the management and control system implemented. Among these, from the perspective of accounting representation, there is a causal relationship, by which good or poor governance will put its mark in the accounting representation of the performance achieved, and this in turn will be able to influence the quality of the governing act.

## 5. Conclusions

The research underlined that the risks of non-compliance of information regarding the performance achieved with the represented reality can affect the internal and external decision-making processes in which this information participates. Therefore, there is a dependency link between the decision-making act within the management and governance system and the quality of the processes through which the usefulness of the information is ensured, which in turn can be monitored and influenced by the governance and control actions implemented to achieve the qualitative characteristics that inform them. give value.

Implementing a general strategy for achieving global and, implicitly, financial performance, stimulating sustainable development as the basis of a competitive business environment or satisfying the public interest, requires a complex approach to corporate governance and the processes and systems with which it interacts. In this context, in addition to a high degree of transparency, good corporate governance also has a positive effect on the financial performance of the entities in which such systems are implemented, and consequently in protecting the divergent interests of the different stakeholders.

In conclusion, it has emerged from the research conducted that a decisive role in ensuring a high financial peer performance has the mechanisms of corporate governance. On this basis, as a condition of sustainable and sustainable development, in the empirical research it was stressed the need to implement the principles and rules of corporate governance and in the case of smaller or public economic entities.

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