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Corporate governance and corporate performance

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Corporate governance and corporate performance

1 Introduction

Corporate governance has started playing an increasingly critical role in corporate strategy to create the long-term organizational success, especially when thinking to competitive and dynamic global markets. These elaborate studies the strong relationship between corporate governance practices and corporate performance, analyzing the latter on a sample selected within Italian listed companies. The main research question tryies to understand if the adherence to solid governance principles is directly correlated with better corporate performance and defines which specific governance practices exert the most significant influence. This investigation has an important relevance due to the growing complexity of stakeholder demands and the deepened focus on corporate accountability and transparency.

Modern organizations are facing many hard challenges with corporate governance considered as the main tool to address them. From an historical point of view, governance frameworks were initially programmed to address agency conflicts of interests between shareholders and management. Over time, this approach has broadened to address many more problems, including balancing shareholder interests with those of different stakeholders, pursuing long-term value creation, and addressing social and environmental goals. Corporate governance now is used not only as a mechanism for supervision but also as a strategic tool for achieving organizational goals and responding to external pressures by different stakeholders.

The relevance of corporate governance has increased after many failures and scandals related to apparently solid and strong companies, which have underlined points of weaknesses in traditional governance structures and highlighted the need for better and stronger frameworks. After this, the role of governance mechanisms such as board composition, independence, diversity, and accountability has started having more

attention by the doctrine. These elements are recognized as crucial in decision-making processes, mitigating risks, and pursuing innovation and resilience. Said this, understanding the impact of governance practices on corporate performance has significant implications for policymakers, investors, corporate leaders and more in general for all stakeholders of the company.

This thesis aims to participate to the expanding body of literature by examining the relationship between corporate governance and performance using a strong empirical analysis based on Italian listed companies. The study is based on a robust methodological framework, which uses quantitative techniques to assess the influence of governance elements on key performance variables such as Return on Assets (ROA), Return on Equity (ROE), and market-based metrics. By analyzing these relationships, the thesis wants to give some useful insights into how governance practices can be optimized to reach corporate success.

The structure of this thesis follows a comprehensive approach to this subject. It starts with a theoretical analysis of corporate governance, looking to its historical evolution and defining its fundamental principles. This creates the base for a critical review of the existing literature on governance practices and performance, underling the most important themes and highlighting gaps in understanding. The methodological chapter explains the research design, including how the selection of governance and performance indicators has been made and which analytical tools have been employed. Empirical findings are reported and then discussed more in detail, providing evidence of the relationships between governance variables and performance results. Finally, the elaborate is concluded with a resume of key insights, a discussion of limitations, and recommendations for future research.

The relevance of this research lies in its potential to contribute to both academic debate and practical applications. By defining the links between governance and performance, the study provides a strong guidance for improving governance frameworks and aligning them with organizational achievements. Furthermore, the results have broader implications for the role of governance in sustaining health economic growth and addressing the challenges of an interconnected and rapidly evolving business

environment. This thesis ultimately tries to enhance the understanding of corporate governance as a broad and dynamic field, emphasizing its critical role in drawing the success and sustainability of modern companies.

In addressing these themes, the thesis contributes to a deep understanding of the relationship between governance and performance, offering results that are both theoretically and practically relevant. By focusing on the specific context of Italian listed companies, the study provides a unique perspective on how governance practices are influenced by and respond to regional and cultural elements, adding relevance to the global conversation on corporate governance. This dual focus on theory and contextual relevance underscores the elaborate's commitment to advancing knowledge and fostering practical improvements in the field of corporate governance.

2 Corporate Governance and Theoretical Concepts

The relevance of corporate Governance has increased during last years, playing a fundamental role in defining the performance and the value of a company. Indeed, both inside and outside the academia the interest about corporate Governance has increased with the increasing relevance of the topic. Even though it seems to be recent, corporate governance is playing an important role since legal entities are used to conduct business. More in general, the use of corporate governance and its tools starts to be crucial when companies become so big that shareholders have no chance to control the entire business and start to delegate power to directors. Corporate Governance refers to all principles, systems and process used to manage the company itself. It defines how shareholders, board of directors (Bod), management and other stakeholders, distribute rights and responsibilities among each other, and which are the most important procedures to make decisions for corporate affairs.

The purpose of the corporate governance is to create long-term value for the company, also granting transparency, accountability, and fairness in company's relationship with his stakeholders. Corporate governance's relevance and potential is efficiently described in this way:

"By adopting principles of good corporate governance, companies in developing countries can often command higher valuations, improve their profitability, and gain better access to out-side capital than their poorly governed peers. Developing countries can attract more interest from local and foreign investors and reduce their vulnerability to financial crises."[1]

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[1] *World Bank website on Corporate Governance*

2.1 Historical Evolution

In order to understand the relevance of corporate governance, is necessary to look back starting from the early 19th century, which was a period characterized by shareholders with unlimited responsibility for their own company's liabilities. Indeed, in that period the concept of companies as legal entities with limited responsibility for shareholders was not born, making investors' interest for those companies lowering due to the high level of risk.

The first key change which influenced a lot of companies' decisions, and as consequence the relevance of corporate governance, was the possibility to give a legal entity to companies. This was a crucial factor in attracting investors who were taking limited risk, and more in general made it easier for companies to collect capital since the average level of risk on investors was significantly lowered. Some of them decided to list shares on the market in order to attract easily big quantities of capital, contributing at the same time to let the separation between ownership and control problem arise. Company's ownership was divided among large number of shareholders, while control was exercised by some managers that usually were not mentioned in the shareholders list. This was the first time in the history (early 20th) that the right to receive the residual incomes was held by shareholders and the decision taking one was held by managers.

Ownership and control debate starts in this period, the attention is on managers' behavior who are conducting business with financial resources coming from other people, which means that the effort used to do so won't be the same they would use if they were directly company's owners. Probably managers, will put personal goals before company's ones. Moreover, is debated also the scope of corporation, which now are considered as legal entities. If on one hand a part of the literature argues that companies must work and produce results in order to grant shareholders their expected returns, since they invested money and took the entrepreneurial risk, on the other hand some authors define that companies' duty is not only the economic one, actually those entities have also social ones to make positive externalities, even if sometimes this could implicate lower economic return.

Now is possible to notice what was highlighted before: corporate governance increases his importance and becomes more relevant as time goes on. In 1960 the problem of separation between ownership and control is addressed with market behavior; the most

followed idea is that managers drive public owned companies pursuing their interest, but this is not the only goal they can consider since achieve results for the company is considered necessary in order to avoid company's shares undervaluation. Indeed, this would mean taking the risk to be subject of hostile takeover, which usually means total management team's change. The right behavior should be to find a balance between personal, company and society's goals.

Ten years later companies start to fail, there are many cases of bankruptcy which highlight the relevance of corporate governance in debates; the focus now is on board of directors, which often does not perform his role as well as it should. Indeed, for many directors, being appointed in a Bod means to be gratified for their successful careers, a proposal which often is accepted without taking into account all responsibilities that being in the Bod gives. Often board members totally delegate their role to the CEO and the management team, who are never challenged or corrected for their decisions or while taking them; their contribution comes only in bad situations. The main proposal, to solve this problem was to increase the number of non-executive directors and to create an audit committee. Indeed, a board composed of non-executive and independent directors is believed to better monitor the CEO and management team's work. The second proposal comes from a strong pressure by the SEC: even if already four decades before the securities and exchange commission recommended the introduction of an audit committee, in the 1970 the pressure on companies started to increase, in order to have a higher control on managers given as anticipated before the high number of bankruptcy and failed companies. Another evolution with respect to previous years which characterized this period is the lowered tolerance regarding multinationals' impact on the society. During the reconstruction period after the second world war people were very tolerant about pollution and negative externalities coming from multinationals due to the need of investments. After this, once the main part was reconstructed and the society started a new life, the greatest part of the population started going against the idea that companies had only economic goals and thinking that also their social impact matters. So, the idea is that those companies reached too big dimensions to ignore their impact on all stakeholders, who pushes for more stringent regulation to avoid negative externalities on the society.

The increasing financial instability, together with the succession of some relevant scandals and many negative trends all around the world increased the attention on corporate governance tools' efficiency. During the 1980 decade the focus was on the separation between CEO and chairperson: the potential union of those roles would have meant too much power to a single person. Imagine a situation in which a board member must challenge the CEO and president of the company: none would take the risk to do so due to the risk of not being confirmed in the bod; everything would probably end in a group of yes man that just confirm what he wants. In this period managers were, following someone's idea, pushed to perform better by the increasing number of take overs given that be subject of takeover would mean, probably, be substituted and lose the job. This decade was finally characterized by an enormous debate on CEO's compensation that was often considered to be too high and not fair. What was argued is that their salaries were too high, and people were questioning themselves about the possibility of creating a limit to their level of compensation or to the maximum difference between the most paid and the less one within a company. Moreover, what sounds strange and without a sense is that those salaries were not linked to their performance (and so the stock's one) which is why part of the literature defined that CEOs' compensation should have been linked to the value created for shareholders.

The last decade of the 21st century has been characterized by the increasing relevance of institutional investors' role in the shareholders meetings of big, listed companies. Indeed, many of these were privatized at that time, giving institutional investors the opportunity to build substantial holdings. This is due also to money that they were able to collect thanks to families who began to entrust their savings to institutional investors. What was changing in their strategy is the relevance of their stake, which made more difficult for them to use the exit strategy as winning one. Funds' managers started building ways to influence companies' Bod and in particular to participate in the decision-making process, especially regarding some crucial decisions ad the CEO designation could be. After some scandals coming from managers crimes, which influenced big companies' life, corporate governance's relevance started increasing more and more, but the focus remains on the same points considered the decade before. What, instead, seems to change is the truly importance that this discipline starts to have within the daily company life. All over the world, in this decade, first corporate governance codes have been developed in order to

disseminate some recommendation to all companies on how to govern the company itself. The main objective is to protect minority interests by limiting manager's power.
The wave of corporate scandals which characterize the first part of 21st century, like the Parmalat one in Italy, negatively influenced people trust in big companies and in authorities which should control those companies' managers. The speculative bubble contributed to those failure and to increase families' diffidence regarding markets. The 2008 crisis create a strong depression, which soon influenced also financial institutions creating a strong depression with unemployment rate which grew. Some critical points have been underlined by the crisis and influenced the governance approach for ever: as first, managers' compensation schemes were not built in the correct way since they were in many cases pushed to look only to short term goals and often, to reach them, used to cheat creating future damages to the company because of the high level of risk that those managers took for the company. Moreover, board members were not able to prevent the excessive risk-taking policy or to exercise control over managers work. Boards were not able in many cases to develop an independent point of view and were often composed in a way which gave excessive power to the management team.
This crisis was an important lesson for authorities, which started to prevent similar situation for the future. Companies started understanding their social role and that this was directly linked to their performance and influenced the latter.
Is from this sequence of events that main governance principles have been developed all around the world.

2.2 Fundamental Principles of Governance

The principles of corporate governance aim at providing a reference point for policy makers to develop their frameworks of corporate governance. The idea is to define some important and general goals, which are suitable for a generic company, and suggest the best way to achieve them, involving elements of legislation, regulation, listing rules, self-regulatory arrangements, contractual undertakings, voluntary commitments, and business practices. In order to be actual at every time, recommendations by OECD have been updated many times during the history in light of significant changes which influenced the corporate governance; the most recent redesign was made in 2023. Obviously, the substantial application of the corporate governance principles must be done in accordance with legal framework of the specific country. Indeed, in the official document provided by OECD is possible to read that "*The Principles are non-binding and do not aim to provide detailed prescriptions for national legislation. The principles are not a substitute for, nor should they be considered to override domestic law and regulation.*"[2]

Principles are studied basing on large companies with public shares. This means that they could also be applied in non-public companies, but they are not built to be applied to those companies. What must be clear is that there is not a standard model of corporate governance which can be applied to every corporation in order to reach the best success, since principle are define only to guide companies to create their own corporate governance model.

All principles are designed as outcome-oriented, in order to suggest only some elements which are common to successful companies. So, in each jurisdiction we will have some corporate governance framework which are written on the principles defined by the OECD, and dedicated to specific companies (e.g. there is a code for non-listed companies and one for listed ones).

[2] Recommendation of the Council on OECD Legal Instruments Principles of Corporate Governance, 2023

Main principles worldwide:

Before analyzing specific requirements coming from codes of corporate governance, which for sure will be useful to understand in practice what is the role of a corporate governance code and his implications, in the following paragraphs we will highlight the main principles of corporate governance framework by OECD which represents a common basis for the most important codes of corporate governance worldwide. Moreover, what is important to underline is the “non-binding” characteristic of corporate governance principles; once a company decides to follow a specific code, they can decide which principles among all will be applied, basing on the comply or explain principle. Indeed, the idea is that when a company, which decided on a voluntary basis to follow the code, wants to avoid the application of a specific principle it is mandatory to explain the reason behind the latter decision in order to grant all stakeholders, with a transparency tool. Companies which decide to apply a code must explain how they applied in the principles and, if they did not, which are the reasons behind this choice. Moreover, following what is defined in the Italian corporate governance code for listed companies, also the way in which the decision to avoid a principle’s application has been taken, if the company believe they will apply the recommendation in the future, and finally if this is the case, when they will start to reapply the latter.
The common basis for all corporate governance codes is made by some principles, which are:

1. Accountability:
   The Bod must be accountable to the shareholders and other stakeholders, ensuring that all activities are performed ethically and responsibly. This means that the Bod is responsible for company’s performances and should conduct them following the best interest of the company at every time.

2. Transparency:
   Information package disclosed by the company must be accurate, clear and complete. In order to be accurate, the company must disclose detailed information. The information package can be considered complete if detailed information

regarding financial situation, performance and governance processes are disclosed. All those information must be clear, in order to provide stakeholders with all necessary means to take informed decisions. Finally all information must be disclosed timely, so that stakeholder can use them.

3. Fairness:
   All shareholders should be treated equally, regardless to their stake in the company. No classes of shareholders should have advantages with no motivation which can justify the latter.

4. Responsibility:
   All businesses should have a positive impact on the society and must perform their activities in compliance with the legal framework and the ethical standards. This must be granted by all Corporate Governance codes.

5. Risk Management:
   Boards are responsible both for the identification and the mitigation of risks. In particular, is up to the board to notice in advance financial, operational and reputational risks and to build up efficient systems to mitigate those risks.

6. Independence:
   The Board should include independent directors (also characteristics to be considered independent are disclosed) in order to grant minority interest to be protected. The risk which is mitigated with this provision is the possibility that a majority interest is protected and dominate the company as well as his decisions, without any consideration regarding minority interests.

The board of directors is central when talking about corporate governance; it is chosen by company's shareholders with the aim that directors will manage according to the shareholders' and the company's best interests. Their main role, among others is to discuss strategies and make key financial decisions that will lead the company toward long-term prosperity and sustainability while safeguarding the interests of all shareholders and

stakeholders. From corporate governance to corporate ethics and social responsibility, board directors are expected to have individual expertise and contribute with their knowledge during discussions to collaborate with other directors on defining the best course of action. Boards are divided into committees, each overseeing a specific area of the company's performance. The structure and the nature of these committees depends on the type of company and its goals. Typically, board terms are staggered to prevent hostile takeovers. Indeed, only a part of Bod members can be re-elected each year. However, someone argue that this influences negatively the accountability of Bod, supporting the idea that this practice can make more difficult to substitute nonperforming members. Candidates are elected during a corporation's annual general meeting by current board directors and shareholders and should have some level of managerial experience. However, many companies are now changing their criteria for board candidates, reducing the required managerial or board experience, and focusing instead on the unique expertise a candidate can bring to the company. A company might select a former IT expert or software developer without previous board experience if the objective is to improve its technological strategies. As mentioned before Corporate Governance codes are written with the aim to grant that some basic principles are shared among companies in order to protect some minority interests. These codes provide recommendations which even if are non-binding should be respected in order to avoid bad judgment by the market which can influence directly the stock value and, more in general, company's performance. There are a lot of recommendation that should be considered when building up a Bod, in order to increase company's performance; some of them are:

1. Independence: Having a quota of independent directors is important regardless of the company type or direction, as it reduces bias and external pressures in the boardroom. The Securities and Exchange Commission (SEC) requires that public companies have the greatest part of directors that own independence characteristics within their board. Independent directors are preferred because they are more likely to provide an objective opinion on what is best for the company and are less likely to follow trends that primarily serve upper management. Independent directors must also have strong business expertise to accurately translate their opinions into financial decisions and approve transparent financial statements. Nowadays, on average, the percentage of independent member is

85%, as the study of Spencer Stuart (2023 U.S Spencer Stuart Board Index) based on S&P 500 firms demonstrates. There are some characteristics that a director should have and maintain in order to be considered independent, those are:

- must not own shares in the company to an extent that would enable him to exercise control over it, or otherwise to an extent that would interfere with his independence.
- must not hold other positions that place him in conflict of interest with the company.
- must not hold the office of director of the company for periods of time such as to allow the establishment of ties that debase his independence.
- must not be, or have been, an employee of the company, or of an affiliate or subsidiary.
- must not provide or have provided to the company, or any of its affiliates or subsidiary, any service or product, or be an employee of a company that supplies or has supplied them.
- must not be a relative or kin of any employee, director or controlling shareholder of the company.

2. Diversity is another key aspect of board composition. The diversity is considered both in terms of skills and in terms of gender/provenience. While board members are expected to bring at least one area of outside expertise, successful boards today are composed of directors who are experts in multiple topics. It is now well-encouraged for company boards to recruit recent college graduates with a major in business and minors in related fields such as cybersecurity, data science, or marketing management. This ensures that the board is composed of the most up-to-date, well-rounded intelligence. There has been increasing pressure for companies to appoint more women to their boards to reflect a more independent selection process. The reasoning is that companies with a predominantly male board are more likely to have biases in their selection process and are not guaranteed to deliver a diversified range of opinions that serve public interest. A more diverse board brings a wider range of robust expertise and perspectives. Gender quotas are aligning with this recommendation as we can understand from the study presented before, which underlines that today we have the 33% of women in the board

on average. Moreover, what they precise is that the new appointed members are composed for the 46% of women, showing the trend direction toward greater equality.

3. Another important topic is the number of member and the number of committees. The number of directors must be decided in order to have enough different skills among the board, so to have many different points of views, but also considering that too many people could represent a problem in terms of length of the meetings. Too few directors may undermine board diversity, while too many directors may reduce board cohesiveness and individual contributions to discussion and debate. On average the number of directors is 11.2 considering the study published by Spencer Stuart. Committee are required to debate regarding a specific topic and advance proposals to the Bod, in order to address specific issues (usually committees are non-executive). Basing on the same study mentioned before, on average the number of a committee's members is between 3 and 5 and the average age of board members is 60 years.

4. Last but not least, best practice of corporate governance requires to avoid the CEO Duality phenomenon, which arise when the CEO and the Chairperson are the same person (which happens in 41% of the cases analyzed by the study considered in this paper). This is required with the aim to avoid a strong concentration of power in the hands of one person which can lead board members to be just "yes man" instead of providing objective (and may contrasting) opinions which are necessary to pursue shareholders' and company's best interest. Indeed, in case of CEO duality probably having independent directors, or a relevant level of diversity, could be useless since CEO would have too much power, and probably will decide alone exercising pressions on other members of the Bod to just approve his proposals.
   Moreover, also looking at this problem from the Bod members perspective, is very easy to find some problems. The most important is the convenience for directors to support CEO's ideas in order to be confirmed or to be in good relationship with a powerful person which can open them successful career roads.
   When the CEO and chairperson roles are separate, the board is more likely to challenge the CEO's decisions and ensure that the company's strategy is in line with shareholders' long-term interests. Studies show that companies with a clear separation between the

CEO and chairperson roles are better positioned to manage risk and promote transparent governance.
The CEO is the highest person in terms of role within a company from an operative point of view. He is the most important executive person; he oversees the daily strategic and operative administration of the company. His appointment represents one of the most important and crucial decision made by the Bod; usually not only the experience is considered while appointing the CEO, but also the fit between company's culture and the appointed person. Once he is appointed, he plays his role in direct and constant contact with the Bod, defining with them objectives and strategies to use in order to achieve the latter within a specific date. He has also an important role outside the company, which is to represent it talking with all stakeholders; he will be, obviously, responsible in total for the company's performance.

5. Finally, best practices recommend establishing term limits to consistently refresh and evolve board composition. In the past, board members were routinely reappointed at the end of their terms. However, this practice has changed as it often results in stagnation and the repetition of the same viewpoints, leading to a loss of independence. With today's rapidly evolving technological and corporate landscape, board directors are expected to serve a maximum of 12 years (the average tenure is 8/10 years basing on the study made by Spencer Stuart). This standard is intended to create more vacancies for new, forward-thinking members. Some companies set a limit to the retirement age, which in the greater part of the analyzed cases is 75 or more.
With these practices in mind, nominating committees have much to consider in electing the most qualified, highest-performing board. The key takeaway is that, regardless of the service a company provides or the industry it belongs to, all companies need a highly independent, diversified board with expert knowledge in a wide range of fields to successfully oversee management and lead the company to success. In my opinion the best thing to do is to follow the best practices but customized to the single specific case. For example, having regard to the committees, the perfect way to approach is to define some basic committees (audit, compensation, nominating and governance) and if is needed for specific situation in which the company operates, appoint some "temporary" committees. For example, if the company is evaluating an M&A deal is possible to select

a committee which is required to look at this issue. Even the selection must be made, basing my idea, considering the company’s goals for the short and long term, but trying at every time to cover all possible problems that the company may will face with different and strong certified skills held by directors.

2.3 Governance and corporate performance theories

An important question to answer is the one which asks what are the goals that a company should pursue, shareholders or stakeholders' ones. To answer this question is needed the support of stakeholder value creation theory and shareholder value creation theory. The latter defines that the company should pursue the shareholder value creation, meaning that shareholder's needs are those to satisfy as soon as possible since they are those who are remunerated on a residual basis, and those who can be expropriated by top managers. Shareholders provide company with their money receiving in exchange shares; once the year ends, they can either receive a part of the profit, either they must cover a part of the losses coming from the operations. Even if when they must cover losses they are considered as first responsible, when they company creates profit, they will be remunerated as the last category after everyone else is remunerated. This is why they have a strong interest to push managers to create value and make good performances. Moreover, all stakeholders have many different possibilities to renegotiate the terms of their contracts or to cover their interests, while shareholders cannot do the same. Indeed, shareholders, are not able to negotiate contract condition and are potentially constrained till the end of company's life. Following this idea, board members who are appointed by shareholders are required to fulfill owners' interests, as to give them a premium for the risk they take with the investment in the company.

On the other hand, following the stakeholder theory, those who supports this theory, argue that the company has not only the role to fulfill shareholders' needs but also a social responsibility towards the society. When deciding what to do and how to run the business managers must consider not only the maximization of profit but also all consequences that will have an impact on the society. Following this approach, its supporters, believe that the stakeholder theory can bring companies to create great sustainable value in the long-term, since all stakeholders as for example employees are satisfied. Maybe often, to follow this way, companies spend some money or lower some revenues in order to produce positive externalities that will probably produce greater returns in the future also for shareholders which are penalized in the first phase.

One of the most important theories which influenced the corporate governance world and its studies, is the agency theory, which defines a specific type of relationship (the agency relationship) which is the one used in company life, between shareholders and managers. The agency relationship is defined as the one between two people in which the principal delegates to the agent some activities. When delegating the principal is going to set some rules that are going to regulate the relationship, while the agent will carry on his activities following the latter and performing the best result he can.
In this theory the agent, as other people, is supposed to be rational with the main goal to maximize his own return. This means that he would probably pursue his own goals at the expenses of his principal. Some problems may arise when the agent is not able to directly control his outcome or when even if he can control it, the principal is not able to control the actions made by his agent ending in an information asymmetry. This situation creates agency costs which can only be reduced and not eliminated, such as: control costs, reassurance costs, and residual loss. What can be done to reduce costs is, for example, introduce incentives that reduces the distance between principal and agent's interests.
Different types of companies with different characteristics, usually incurs in different type of problems. Indeed, as it is easy to imagine, the problem varies basing on company's characteristics. There are three types of problems that we are going to define in the following lines:

1) Principal-agent problem:
   This is characteristic of big companies, with listed shares distributed among large number of shareholders with small participation. Indeed, investors probably cannot afford an important number of such companies' shares, and even if they were the probably would not do so in order to diversify their portfolio and to be able to divest easily if is needed. This led to the main problem, which is the absence of participation by shareholders, that are not going to exercise their control right over the company, usually delegating key decisions, to the board of directors. The bod is probably strongly influenced by management team and in particular by the chief executive officer. Moreover, the interest held by the single shareholder is too small with respect to the effort he should put to exercise control over the management team; each of them hope that another one will do so, and finally none do it.

This condition is the perfect one to allow managers to do what they want, especially to pursue their own interests with shareholders' money. The emblematic case is usually the CEO behavior since he is the most powerful person within the company.

2) Principal-Principal problem:
In this case the possibility for managers to act with opportunism is truly restricted thanks to the majority shareholder. This problem arises when there is a shareholder with a strong participation within the company, which allows him to influence the shareholder meeting and so the most important decisions taken by the latter. Ideally, he is also the one with the greatest interest about the performance of the company since he will be the one who will receive the highest slice of cash flows. Even if the managers' opportunism problem is solved, now the majority shareholder is too much powerful: in this way he can drive the company to take decisions which are taken only to promote his best interest, which usually is different with respect to the company ones. Moreover, also minority shareholders are not awarded by this situation since their interests are not covered and they are not able to influence company's decision-making process.

3) Third type problem:
The third type of agency problem is the one in which who suffer are the stakeholders. Indeed, when shareholders pursue their own goals, they can also do it making their best interest or the company's one and going against stakeholders' ones. Indeed, as we understand the company has also some obligations towards society, which are often considered after company or shareholders' ones. This type of problem can arise with all type of stakeholders, because all their interests can be damaged.

Another important theory which is totally contrary to the agency theory is the stewardship one. The stewardship theory gives to managers, the role of company's stewards, and assumes that they will act pursuing the best interests of shareholders and organization as a whole. Contrarily to the agency theory, which underlines a natural conflict of interest between agents and principals, which are respectively managers (the former) and shareholders (the latter), that requires to be constantly monitored and aligned usually with incentives, stewardship theory believe that directors are intrinsically motivated to reach

the company’s goals basing on a sense of responsibility, loyalty, and long-term effort. Following this view, they will prioritize company’s success over personal goals, and the need for constant control and incentive systems is minimized. The stewardship model, therefore, highlights trust and cooperation between managers and owners, while agency theory focuses on control mechanisms to reduce opportunistic behavior. This fundamental difference leads to contrasting governance structures, with stewardship theory arguing that managers are autonomous, while agency theory supports a system of checks and balances to safeguard shareholder interests and to avoid managers’ opportunistic behavior.

3 Relationship between Governance and Performance

This elaborates main goal is to analyze the correlation between corporate governance and performance. Being more specific, what will be analyzed is if there is a relationship between governance practices and performance of the company; is possible to say that to a better governance corresponds a better performance?

Before conducting an empirical study, which will analyze some companies, this paragraph's purpose is to understand what has been already presented in literature, analyzing some elaborates from top sources.

Most studies evidence the presence of a positive relation between corporate governance and performance of the company. What is common between all studies (or the greatest part) is the believe that the question can be divided in two parts in order to increase the efficiency of the study. The basic question is if there is an association, as said before, between corporate governance and performance; the second one, which has a sense only if the first answer is positive, has the purpose to understand if the performance is influenced by the governance adopted or if on the contrary, the better performance influences the company which will introduce a better governance.

If the relationship exist, is easy to conclude that companies can have a direct benefit from better governance and that policy makers can use the governance instrument as tool to influence performances and to contribute to the economic growth of a country.

If improved governance ensures that investors' funds are allocated more effectively, companies with stronger governance practices will likely generate higher profits. This means that good governance can lead to increased efficiency within the company, resulting in higher productivity, more value creation, and overall greater output. Beyond just increasing the overall profit, better governance also plays a key role in determining how these profits are distributed. It can impact how returns are shared between managers and shareholders, ensuring that resources are not misused or wasted. Another key aspect is that governance influences how the power and rights are divided among majority and minority shareholders, directly influencing also how returns are divided among various classes of stakeholders. Governance tools have as main goal to protect minority interests ensuring all stakeholders with a fairer distribution of benefit created, mitigating all risks.

Better governance is also a tool used to guarantee that revenues coming from better performances are distributed equally.

Corporate governance plays a crucial role in shaping various aspects of a company's performance. Its impact can be observed in several key areas. As first, it contributes to define the operating performance, which is also defined as company's profitability, usually measured by metrics like Return on Assets (ROA) or Return on Equity (ROE). Efficient governance ensures that the company's operations are good enough and that directors are focused on the maximization of returns for shareholders.

Also, the market value, which reflects the company's overall worth as seen by the market, is strongly influenced by the governance. This is often measured through Tobin's Q, a ratio which compares the market capitalization to the book value of the firm's assets. Companies with better governance usually show higher market valuations because investors believe that directors are able to manage disposable resources and that they will be able to bring sustainable value to the shareholders.

Another fundamental measure used while evaluating a company’s stock is the return on investment (ROI). This indicator is also impacted by the governance and usually to understand which the impact is the variation over time is considered.

Moreover, is impossible to not take in consideration that the company’s performance is influenced also by other factors and that good governance tools are also an important element to increase the confidence by investors that directly influences stock’s performance.

Corporate governance mechanisms can increase operating performance in many linked ways. Another important benefit is given by the supervision that better governance provides on directors, since in this way managers are encouraged to enter projects which can increase and maximize the value created for the company and pushed to focus on company’s operations. This can lead to higher productivity and more efficient use of resources.

Additionally, fewer resources are wasted on nonproductive activities. In cases of non-valuable governance, the risk that management might engage in activities that don't add value, such as indulging in unnecessary perks, focusing on empire-building, or in shirking is higher. Robust governance mechanisms help to lower these conditions of inefficiency.

Moreover, good governance reduces the risk of harmful practices like tunneling, asset-stripping, and related-party transactions, which significantly lowers shareholders' return coming from the company. In these cases, corporate governance tools are very useful in order to avoid that these activities occur and may undermine company's value, since with proper corporate governance tools these activities are less likely to occur.

Another key benefit is that better investor protection reduces the perceived risk for investors. An investor who is correctly assured about his interests' protection will more probably accept a lower return coming from the company in which he invested. This reduction in required return means lower cost of capital for the firm, and directly impacts profitability increasing potential income.

Finally, strong governance can increase the probability to find external finance easily, making it easier for companies to collect capital to invest in new projects. Improving their access to external capital, firms create many growth opportunities, which further enhances their long-term performance.

Basing on this, we can assume that corporate governance is not just a tool used to control the firm but has a crucial role in enhancing profitability, market valuation, stock performance, and long-term potential growth.

This relationship has been involved in many studies since the early 2000 and is still one of the main topics considered in literature. The first study regarding this topic, was conducted by Black, who founded a strong relationship between the two issues analyzing 21 Russian firms.

Some studies highlight that, in addition to the connection between governance and performance, the latter is considered more important the weaker the country's legal protection is. This result evidences how the firm governance is considered also as a control instrument which can, in some sense and cases, be a great substitute to the legal control, which is often poor or not clear about specific topics. However, there are also some studies that evidences the negative correlation between those issues, as for example one conducted over Japanese firms, which evidences how those with poor corporate governance tools perform better than those with stronger ones thanks to the risk that, if controlled, let the relationship disappear.

Some authors go more in deep with their studies, often crating models which are very specialized; Brown, Lawrence and Marcus Caylor studied how the performance was

influenced by corporate governance in general an than analyzed how each element, within those selected, contributed to increase the performance. In particular the executive compensation is considered to be the most important factor to influence companies' performance. In some studies, also the variation of the performance, after a variation in positive or in negative of some governance tools, have been measured and studied.
What finally is possible to notice in the literature is that many works are conducted basing only on the relationship between performance and one governance element (e.g. CEO compensation, board composition, non-executive directors number).

4 Data and Metodology

In order to better understand the relationship between governance and performance I made an empirical analysis over some companies. The sample has been selected within Italian listed companies, taking for the greatest part those which were part of the Ftse Mib index during the period selected. Considering About 80 companies in a 5-year period all necessary observation between 2019 and 2023 has been selected before computing the analysis.

The model used is an OLS regression, which analyzes the relationship within Panel of data, considering the same variable within a specific time period. In order to better understand the model, here the generic formula:

$$Y_{it}=\beta_0+\beta_1 x_{it1}+\cdots+u_i+\epsilon_{it} \quad (1)$$

As we can see there are two different types of variables:

- Dependent variables: those variables which are computed as result of the study. Using other words those variables which are thought to be influenced by independent ones; those variables are the group we consider as “relevant” in the study.
- Independent variables: those variables which are taken as given and considered in the study since they are thought to influence directly dependent ones. Those variables are selected since we think they can modify dependent variables when their value varies.

Coming to this elaborate’s study, the performance is considered as dependent variable while governance indicators are considered to be independent ones.

More in details, on the performance side some indicators have been selected, both internal and external (market ones) performance indicators. The first indicator is the ROA (Return on Assets) which is computed as the profit (or loss) of the company in a specific year divided by the value of his assets in the same period. The second performance indicator which is considered in the analysis is the ROE (Return on Equity), computed as profit (or loss) divided by company’s equity in the same year. The Third performance indicator is

the Return, a market indicator which considers the return of the stock on the market and is computed as the difference in prices between one year and the previous year, with the addition of the dividend divided by the price of the previous year. Finally, the fourth indicator is the excess return, computed as the difference between the return, and the 2y Italian BTP return, since this is considered a good proxy for the risk-free rate.
This set of variables has been selected with the goal of include all factors that influenced the performance, internal and external ones.

On the other hand, we have governance variables, those that in this study are selected as independent one. In particular, the variables selected are:

- the percentage of women Bod members, which is computed as number of women divided by the Bod's size.
- The second variable computed is the percentage of independent member within the Bod, computed as the number of independent members divided by the number of Bod members.
- The third variable is the percentage of foreign members, computed as the number of foreign members divided by the number of Bod members.
- Also, the Ceo duality cases have been computed but this variable has been excluded due to collinearity.

Moreover, what must be specified is that four different computations have been made; for each performance variable I computed a calculation which included all governance elements.

Finally, in the following table, is possible to observe a resume of all the most important descriptive statistics related to the analysis. As we can see the standard deviation value increase the more values of a specific statistic are distant from the average value. The analysis has been conducted on 79 companies for 5 years, so we have 395 observations for all variables.

Descriptive statistics	Independence	Foreign	Women	Roe	Roa	Excess return	Return
N. OBS.	395	395	395	395	395	395	395
N. GROUPS	79	79	79	79	79	79	79
AVERAGE	56%	10%	38%	5%	9%	14%	15%
MINIMUM	0%	0%	0%	-2620%	-26%	-93%	-90%
MAXIMUM	91%	150%	58%	1828%	798%	258%	257%
STD. DEVIATION	15,1%	16,5%	7,8%	168,9%	44%	41,2%	40,7%

Table 1 Descriptive Statistics

5 Results

ROE	Independent	Foreign	Women	Cons
Coefficient	0.219	-1.581	0.436	-0.083
Robust std. err.	0.240	1.063	0.578	0.222
t	0.91	-1.49	0.75	-0.37
P<|t|	0.365	0.141	0.453	0.709
95% confidence interval low	-0.259	-3.696	-0.716	-0.526
95% confidence interval High	0.697	0.535	1.587	0.359

Table 2 regression governance vs performance (ROE)

In this case as we can see seems that governance variable influences company's performance, but the influence is not very strong on the specific indicator defined in this pic. For example, having a quota of independent members seems to influence positively (but just a bit) ROE's value. This means that when decisions are taken from a super partes point of view, so in the best interest of the company, the performance which is represented by ROE in this case is influenced positively. The same approach can be used with women members, since these results show that the diversity within the board can led to different points of view, and finally to balanced and rational decisions that have as final outcome a good and improved ROE. Moreover, there are some coefficients as "foreign" which seems to influence negatively the performance, contrarily to what expected. This is probably due other external effect which influence the performance and create some trends which are not purely dependent on the foreign factor. Indeed this is not very strong as coefficient, confirming what said before. Rho defines the percentage of the ROE's variation which is related to the differences among groups, in this case is the 28%. R squared values defines how much of the dependent variable is explained by independent ones. In particular the value "within" defines how much the model explain the variation of the variable within the groups, on the other hand "Between" defines how much the model explain the variation of the variable between the groups. Finally, the value "overall" defines how much the model explains the variation of the variable.

RETURN	Independent	Foreign	Women	Cons
Coefficient	-0.840	0.494	-1.054	0.978
Robust std. Err.	0.316	0.146	0.323	0.202
T	-2.66	3.38	-3.26	4.85
P<|t|	0.009	0.001	0.002	0.000
95% confidence interval low	-1.468	0.204	-1.697	0.576
95% confidence interval high	-0.211	0.785	-0.410	1.379

Table 3 regression governance vs performance (Return)

In this case what seems to be interesting for our purpose is that the number of foreign bod members influences positively the value of the return. This means that, also in practice, we can say that the diversity contributes to have different points of view ending in better decision-making processes and better final decisions taken. Moreover, there are some coefficients as “women” and “independent” which seems to influence negatively the performance, contrarily to what expected. This is probably due other external effect which influence the performance and create some trends which are not purely dependent on the foreign factor. Rho defines the percentage of the Return’s variation which is related to the differences among groups, in this case is the 21%. R squared values defines how much of the dependent variable is explained by independent ones. In particular the value “within” defines how much the model explain the variation of the variable within the groups, on the other hand “Between” defines how much the model explain the variation of the variable between the groups. Finally, the value “overall” defines how much the model explains the variation of the variable.

EXCESS RETURN	Independent	Foreign	Women	Cons
Coefficient	-0.863	0.480	-1.194	1.034
Robust std. Err.	0.318	0.145	0.323	0.203
T	-2.72	3.31	-3.70	5.09
P<|t|	0.008	0.001	0.000	0.000
95% confidence interval low	-1.495	0.192	-1.836	0.629
95% confidence interval high	-0.230	0.769	-0.552	1.439

Table 4 Regression governance vs performance (excess return)

Also in this case the most interesting variable is the foreign bod members one, which defines that the presence of foreign members is a factor which influences positively the performance of a company, in this case computed as excess return. Moreover, there are some coefficients as “women” and “independent” which seems to influence negatively the performance, contrarily to what expected. This is probably due other external effect which influence the performance and create some trends which are not purely dependent on the foreign factor. Rho defines the percentage of the Return’s variation which is related to the differences among groups, in this case is the 22%. R squared values defines how much of the dependent variable is explained by independent ones. In particular the value “within” defines how much the model explain the variation of the variable within the groups, on the other hand “Between” defines how much the model explain the variation of the variable between the groups. Finally, the value “overall” defines how much the model explains the variation of the variable.

ROA	Independent	Foreign	Women	Cons
Coefficient	0.172	0.134	0.459	-0.199
Robust std. Err.	0.567	0.130	0.351	0.400
T	0.30	1.03	1.31	-0.5
P<|t|	0.762	0.304	0.195	0.620
95% confidence interval low	-0.957	-0.124	-0.240	-0.994
95% confidence interval high	1.302	0.393	1.158	0.597

Table 5 Regression governance vs performance (ROA)

Considering the effects that the governance has on the ROA, we can see that in this case all variables have a positive impact on the Return on assets. More specifically this means that having independent points of view which influences the decision-making process influences positively the result. The same approach is used to evaluate the diversity results which show that, the more the Bod is diversified in terms of people's characteristics the more the result is influenced positively. However, as we can see all factors have low values, meaning that the explained effects are not very strong, probably because obviously the ROA value is influenced only in part by governance and for the rest by other elements, maybe by operative ones. R squared values defines how much of the dependent variable is explained by independent ones. In particular the value "within" defines how much the model explain the variation of the variable within the groups, on the other hand "Between" defines how much the model explain the variation of the variable between the groups. Finally, the value "overall" defines how much the model explains the variation of the variable.

In conclusion what we can argue is that the governance influences the performance of a company on average. Basically, the performance is a very large concept which is influenced by many factors and elements, so the governance can on average explain only part of the variation of the company performance. Moreover, the period selected is a particular one, in which some events influenced all companies, and this can have an impact on the analysis.

Respecting the governance codes and practices, being aligned to the principles can be for sure a first step to address performances goals. This won't mean that, once governance is defined, performances will come as consequence since as said before performance, which is often represented only as a number is a collection of many elements.

6 Conclusion

As thought initially, this text confirms that corporate governance has an impact on corporate performance which has been measured before, obviously with different degrees of influence basing on the governance variables and key performance indicators analyzed. The empirical results highlight that factors such as board diversity, independence, and international composition play important roles in shaping key performance metrics like ROA, ROE, and market returns. While positive effects were observed, the relevance of these effects was often modest, reflecting the varied nature of corporate performance determinants.

The results emphasize that adopting governance best practices, such as promoting diversity and pursuing independent decision-making, can create more balanced and strategic outcomes. However, external factors, including market conditions and economic shocks, significantly influence this relationship. The study also underlines that governance improvements alone cannot guarantee better performance but serve as fundamental basis of long-term value creation.

Key limitations of this research include the focus on Italian listed companies and the reduced timeframe analyzed, which may limit the generalizability of the results. Future research could expand the scope by incorporating other companies from different countries and expanding the temporal sample, examining more governance variables, and exploring the relationship between governance and other emerging themes such as ESG criteria.

In conclusion, this thesis contributes to understanding the governance-performance connection and increase the importance of aligning organizational goals with governance practices and stakeholder expectations. By doing so, companies can not only improve their operational efficiency but also create sustainable and resilient business models.

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