

# ***Corporate Governance and Firm Performance in China: A Comparative Case Study of China National Petroleum Corporation and Other Four Asian Corporations***

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**Abstract:** The study examines the impact of corporate governance on China Petroleum Nation Corporation and compares it with other selected four firms within China and Asia region. The variable identified for measuring corporate performance in this study includes return on Assets, Board size, duality, and interdependence of the board members as of 2022. The impacts of corporate governance on the firms were established through collecting information from the company's annual reports. The data obtained from the reports have been used for descriptive and correlational analysis. From this study, it has been established that firms within Asia tend to use various elements of structure to determine their performance. The variables used in the analysis, such as duality, the board size, and the interdependence of the board members, had a significant positive relationship with the firm's performance. The study concluded that company directors should balance critical corporate structure variables to attain high organizational performance. Proper corporate governance has a significant impact on the performance of a company.

**Keywords:** board structure, board size, independent directors, firm performance

## **1. Introduction**

One of the primary responsibilities of the company's board of directors is to determine the strategic objectives and policies that need to be attained by the company. Establishing such measures is important, especially in ensuring progress for specific objectives and policies are attained [1]. Besides, in companies, the board of directors has an important role in monitoring progress towards the realization of objectives and policies. That implies that the company's managers must align the operations of the company to realize the interest of the shareholders. It is possible that a company manager (agent) might have a different opinion from that of shareholders. According to Kyere and Ausloos, the main source of conflicts within companies and among key stakeholders tend to be asymmetric information resulting from the imperfect contractual agreement among core managers [2].

Corporate governance is one of the core areas that is given significant attention by top managers of a company, such as the directors. From the corporate governance perspective, the company directors are responsible for governing, supervising, and monitoring the company's management to enhance effective management and guarantee accountability to the company's shareholders.

The responsibility that many companies have through their cooperate responsibility, in some cases, is defined through legislation [3]. As such, corporate governance, to a wide extent, is associated with firm performance. Davidson et al. noted that there is a significant association between firm performance and corporate governance [4]. For example, a firm that has implemented significant corporate governance has a higher capacity of attaining sound financial performance since the firm values quality reporting. It is also evident that such a firm's ability to provide informative disclosures and price-sensitive information is important in promoting strong performance.

One of the recommendations by the Chinese government for its national firms is that they need to promote desirable corporate governance practices. As such, the Chinese government has released core principles of corporate governance. For instance, one of the recommendations by the Chinese government is that companies within its bounders should ensure that they comply with fair disclosure of their annual report.

China National Petroleum Cooperation (CNPC) is a state-owned company. The CNPC was formed through relevant laws and regulations in China, including the Company Law of the PRC and the Constitution of the Communist Party of China [5]. The company has a board of directors who ensures that each department fulfills its duties with an effective balance and through rational decision-making. Christopher (2010) believes that companies should consider that meeting the demands of corporate social performance is not only aimed at realizing economic, environmental, and social sustainability but also for the firm's sustainable development.

CNPC has the responsibility of ensuring that it fulfills its energy challenges and meets consumers' needs of an ever-growing demand for low-carbon clean energy. To that end, the company has ensured that it embraces technological innovation aimed at increasing the effectiveness of hydrocarbon development and utilization. CNP focuses on such efforts and strives to make contributions to the sustainability of clean energy supply and the prosperity of human society.

## **2. Research Background**

### **2.1. Current Issues**

Although a company, through its board of directors and other key executives, has a primary role in the control and monitoring of the activities of the company. Christopher is of the opinion that there is still a significant debate in various literature regarding the usefulness and the impact of cooperative governance on a firm's performance [6]. Some of the views held by scholars focus on the need to maximize administrative control of companies. This would entail adopting more flexible control so that the company's board can make an informed decision after doing reviews of a company's performance [7]. Furthermore, those in executive positions within the company, including the board members, have the capability to access credible information about the company, and that places them in a relatively good position to attain various goals. Goodstein et al. hold the view that directors of a company should pay attention to ways of reducing agency costs, such as through the use of structures that facilitate monitoring of various company operations with the objective of the company [8].

### **2.2. Objective**

This study evaluates corporate governance influences on the performance level of the company via a comparative review of specific attributes of the structure of the company board.

### 3. Literature Review

#### 3.1. The Board Size and Firm Performance

The total number of board members that a firm has as part of its board structure is referred to as the board size [9]. The Number of directors in the organization has an impact on the duties and performance of the board. This is because, each member of the board possesses different skills, knowledge, and experience that are essential within the organization [10]. Research by Bhagat and Bolton indicated a mixed relationship between board size and firm performance [7]. On the other hand, research by Enobakhare and Arora and Sharma suggested that a big board size affects organizational performance [9,10]. Due to the likelihood of a large board size, there is a chance that their settlement will have greater skills and knowledge, which will improve performance. Contrarily, Romano et al. argue that, as the boards get larger, their effectiveness steadily declines [11].

According to Romano et al., smaller boards can boost an organization's performance to a certain extent because larger boards' greater regulating efforts are ineffective due to worse communication, the bureaucracy that often accompanies a larger chain of command, and a tendency for larger groups to be indecisive [11]. The link between the size of the board and the success of the organization has received some attention in research. Guo and Kga argue that a small board size tends to be more appropriate for improved company performance and to be positively connected with it [12]. Similar conclusions were reached by Vo and Phan that smaller boards are more efficient than large ones [13].

#### 3.2. Corporate Governance Theories

**Agency Theory.** Bhaduri and Selarka note that agency theory contends that the separation of organizational ownership and control necessitates the formation of an agency relationship in which shareholders (principals) hire managers (agents) to operate their company on their behalf [14]. With that said, in order to guarantee the distinction of organizational ownership from organizational control, an organization establishes an agency relationship. According to Panda and Leep, a firm is seen as a link between several stakeholders, with the principle at one end and an agent at the other [1]. As a result, the principal and the agent are given separate obligations and rights within the organization, which in theory, should complement one another for the company's financial well-being.

Agency theory is a fundamental concept that can help explain the role of a company's board in ensuring conflict between various stakeholders that arise from the ownership of a company is mitigated. In most cases, one of the functions of the company directors is to minimize such conflict while ensuring that performance is enhanced [1]. As such, the agency theory illustrates how companies need to exist given the assumptions that the company's managers and the shareholders can have contradicting interests and thus undermining its performance. By taking such factors into consideration, the possibility of eliminating risks and mistakes that can affect the company's performance is eliminated.

Bhaduri and Selarka also point out that agency theory contends that managers (agents) are egotistical individuals who are more likely to further their own interests than those of the shareholders (principal) when making operational and strategic decisions for the firm resulting in a conflict of interest [14]. As such, the theory aims to prevent principal-agent conflicts of interest that may arise in the organization by adopting and executing stringent monitoring and control systems that are meant to limit the selfish choices and acts of the management [1]. Additionally, information asymmetry, which is the perception that an agent has more information than the shareholders, makes the principle-agent conflict even worse by generating a moral quandary that can lead an agent to pursue personal interests that might be incompatible with those of the principal. According to Bhaduri and Selarka,

the shareholders have to incur extra costs in order to monitor and ensure the managers adhere to the firm's objectives and pursue the interest of the principal over the interest of the agents [14].

**Stewardship Theory.** The Stewardship theory was developed by Donaldson and Davis in 1991. Unlike agency theory, stakeholder theory is predicated on the idea the managers will make decisions that optimize the firm's performance and overall business value since shareholders interests of the shareholders and the management are mutually exclusive [15] According to the theory, although managers may take actions to further their interests, cooperative behavior is more useful than individualistic behavior; as such, they focus more on the interest of shareholders. Glinkowska and Kaczmarek argue that, through business performance, the agents safeguard and maximize the wealth of shareholders because doing so also increases their utility functions [16].

However, achieving such balance is often difficult and requires the shareholders (principal) to install effective governance mechanisms and structures that will ensure the autonomy of the managers (agents) to take initiatives that will focus on the interest of the shareholders rather than further their own interest [16]. Donaldson and Davis, the pioneers of the model, identified five components that will achieve the equilibrium; open communication, performance enhancement, long-term orientation, trust, and empowerment. With that said, CNPC can utilize the theory to promote the interest of the shareholder over the interest of the managers by applying the five models in their business model and corporate governance.

**Resource Dependence Theory.** The resource dependency theory was developed to highlight the essential role that the board of directors plays in granting access to resources that would improve the company's performance and shield it from externalities [17]. According to Yusoff and Alhaji, in order to operate effectively and accomplish their goals, businesses need resources in different functions such as areas of human resources, finance, accounts, and technical [18]. Having access to resources improves organizational effectiveness and survivability. According to Madhani, the theory focuses on the essential part that directors play in supplying or securing crucial resources to the firm through their connections to the external environment [17].

According to the theory, the directors provide the firm with resources in the form of skills, knowledge, and access to important stakeholders, including policymakers, suppliers, and consumers, among others [17]. Because the majority of an organization's customers come from other organizations, they are dependent on one another for business. As a result, the decisions made by one organization can have a significant positive or negative impact on the other's financial performance. Consequently, businesses must forge connections at the board level. According to Christopher, the theory places emphasis on the nomination of representatives of autonomous organizations as a way to acquire access to resources that are essential to the success of the organization [6].

### 3.3. Insider Shareholder

These refer to individuals in a senior positions within a company, and in most cases, such individuals can be company directors, or they can also hold other senior positions within the company. Jensen and Meckling, as cited in Kyere and Ausloos, observe that people described as insider shareholders tend to have at least 10% of the company's shares [2,19].

Most firms require the financial support of investors to attain additional growth momentum. Evidence from various studies suggests that companies that have established proper corporations and attain a high level of governance can enhance their firm's value. For instance, before investors make the decision to invest in a particular company, they have to assess how the company's corporate governance operates. Mallin indicated that those firms which are widely perceived as having poor corporate governance tend to struggle to get financial support such as a loan or other funding [19]. As such, it is critical for shareholders to evaluate various factors, such as the board of directors' independence and the insider shareholder, so as to determine the extent to which they can invest in a

company. It is important to consider such factors because they signal whether an investor can have confidence in a company or not. That implies that companies must start embracing specific programs aimed at creating confidence in the company, and one of such programs entails strengthening the corporate governance level.

### 3.4. Summary

The findings of this study aim to contribute to the literature by identifying how the company's board of directors, through the adoption of good governance, can contribute to the improved performance of a company. The literature review section underscores that effective corporate governance has a significant impact on the performance of a firm. However, only a little literature has provided details on corporate governance and performance in the context of Chinese firms. Therefore, based on the information details in the literature review section, the following hypothesis is proposed.

### 4. Hypothesis

**H1.** The corporate governance of the CNPC board and other selected firms are expected to have a positive influence on the company's performance.

**HO.** The corporate governance of the CNPC board and other selected firms is not expected to have a positive influence on the company's performance.

### 5. Research Method

This study employs numerous quantitative analysis techniques to determine how the company's board structure influences its annual performance in China. Additionally, the study relies on the detailed financial information of the company to justify the link between corporate governance and its contribution to performance. This study also looks into the corporate performance of three other leading firms in the Asia region, namely Alibaba, Huawei, DBS Group in Singapore, and Jardine Matheson in Hong Kong.

The measure of performance of the corporate governance is through looking at the details such as the board's size, structure, CEO duality, and interdependence. CEO duality means that the company's CEO has more than one core role in the company, such as serving as the chairperson of the company's board and also taking some roles as one of the company's executive officials. In most cases, it is assumed under corporate governance that a CEO who has numerous roles assigned to the office of the CEO leads to the concentration of power.

For empirical analysis, the data used in this study include published financial records collected from the 2016 to 2020 financial year. Furthermore, in this study, the information on the return of assets (ROA) is applied to determine the extent of a company's performance. In many studies, the concept of return of Equity (ROE) and ROA are used to determine how a firm performs within a specified duration, and it also helps to signal the performance of a company over a specified period. As such, ROA is a fundamental financial analysis tool that deserves significant attention.

Table 1: ROA.

Variable	Measures (formula)	Representation
Return on Assets	Net Income after Taxation/Total Assets x 100	ROA

However, in this study, it is assumed that the ROA is determined by the level of corporate governance of the company. As such, the following elements of corporate governance have been given specific attention.

Board Size (BS) = Number of the board of directors for the company

Interdependence board (ID) = Number of independent board/ Sum of board of director's x 100

Duality (D) = Function of chairperson combined with CEO x 100

Therefore, ROA is given by

$$= \beta_0 + \beta_1 BS + \beta_2 ID + \beta_3 D + \varepsilon$$

Table 2: Descriptive Data as at 2022.

Firm	BS	ID	D
CNPC, China	7	3/7	Yes (1)
DBS Group, Singapore	10	7/10	No (0)
Huawei, China	13	3/13	No (0)
Alibaba	10	4/10	Yes (1)
Jardine Matheson, Hong Kong	12	5/12	Yes(1)
Mean	10.4	0.43	0.6
Std. Deviation	2.302	0.168	0.548

Table 3: Correlation between Variables.

	BS	ID	D
BS	1		
ID	.40638	1	
D	.43618	.16354	1

\*\*Correlation is significant at a 0.01 level

The results in table 1 above indicated that the firms have an average board size of 0.43 with a standard deviation of 2.302, which indicates that most of the firms had average independent directors. The table also shows that most of the identified companies in Asia have duality among the top management positions. Still, table 2 shows that the average board size of the company is relatively high such as 10.0. That implies that the majority of companies prefer having a large number of officials within their executive positions. This is significant, especially when making the decision; it is possible to gather insights from a wide perspective and make informed decisions.

Table 3 on correlational analysis of the key variables is significant for this study. In particular, the results show that there is a positive relationship between the company's board size, the interdependence of the board, and duality. These particular findings resonate with some of the findings established in the literature review section that suggested that elements of corporate governance, such as duality and board structure, contribute significantly to determining a firm's performance. An increase in the variables in table 3 is expected to have an increase in the value of ROA.

## 6. Summary of the Findings, Conclusion, and Recommendations

### 6.1. Summary of Key Findings

The primary objective of this study was to examine the corporate governance of the CNPC board in comparison to other firms within Asia is expected to have a positive influence on the company's performance. The study established that variables of corporate governance performance, such as board size, duality, and interdependence of the board, have a significant positive relationship with firm performance. Additionally, an increase in the performance of the variables leads to an increase

in ROA. One of the implications of that findings is that company directors must pay attention to how they can ensure that board size, duality, and interdependence of the board contribute to improved performance of the company.

The study hypothesized that the three elements used to identify corporate performance are important factors to consider when assessing company performance. The average board for the identified companies constituted ten directors. Both descriptive and regression analysis has been used to depict the association between a firm's performance and its governance structure. Although the companies used in the study appear to follow similar elements of firm's performance, CNPC of china had the least Number of board members. The company's board size has a positive impact on its corporate governance performance. One of the potential justification for this is that when a company has fewer individuals on its board, chances are that the board can make informed decisions faster than if the company has many individuals within its board. In other words, a bigger board size would lead to additional conflict, which can undermine the performance of a company in multiple ways, as suggested by Agency theorists.

## **6.2. Conclusion**

Based on the study, it is clear that there is a positive relationship that firms have between their corporate governance and their structure. The elements of a firm structure that defines its performance used in this study included duality, the board size, and the interdependence of the board members. The predictive power of the variables such as duality and board size that they tend to increase firm performance is in agreement with the findings by Christensen et al., who suggested that there is a strong correlation between board size and company performance [3]. The findings on the impact of duality on corporate performance differed from the findings of other scholars, such as Balatbat et al., who argued along agency theory that positive results for companies demand that directors concentrate on specific roles within the company [20]. However, the proponents of stewardship theory believe that a company is likely to succeed if the CEO and the chairperson demonstrate leadership that enhances the overall performance of the company. The performance of a company significantly depends on the variables that affect the structure of corporate governance.

## **6.3. Limitations**

One of the core limitations of this study is that the characteristics associated with the board of directors for the selected companies have been used as proxies to attain the objective of this study; however, the characteristics could be insufficient in this respect. The other limitation of this study is that for the literature review section, there are limited studies that offer specific details on the performance of companies within China and the Asia region. Additionally, the constraints of time during this study, however, issues of the time were mitigated through proper planning for each activity of the study. That ensured that the objective of this study was fulfilled.

## **6.4. Recommendations**

The study has significant implication for company directors; therefore, there is a need for companies to focus on improving their corporate governance by embracing and balancing the variables that affect the corporate structure and its governance. This implies moving beyond the variables identified in this study, such as duality and board size. Further research could focus on identifying how theories such as shareholder theory can help define corporate governance through the identification of other variables that affect the corporate structure.

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