CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE: THE IMPACT OF THE COVID-19 PANDEMIC

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ABSTRACT
The main objective of the paper is to examine the impact of the COVID-19 pandemic on the relationship between corporate governance and the financial performance of Serbian companies. The research was conducted on 22 non-financial companies listed on the Belgrade Stock Exchange between 2018 and 2022. The data are retrieved from the official websites of the Serbian Business Registers Agency and Belgrade Stock Exchange. The results suggest that the impact of ownership concentration on profitability is negative, while the impact on the market value is positive. On the other hand, the size of the board of directors negatively impacts profitability, while the share of non-executive directors in the board of directors negatively impacts market value. Results also indicate that the COVID-19 pandemic affected the relationship between corporate governance and financial performance and that the impact of corporate governance on financial performance was more significant before the COVID-19 pandemic.

Keywords: *COVID-19 pandemic, Ownership structure, Corporate governance, Financial performance, Non-financial companies.*

JEL classification: *G34, H12, L25.*

1. INTRODUCTION

The COVID-19 pandemic considerably affected most countries' everyday life and economic flows (Breuer *et al.*, 2023; Donthu and Gustafsson, 2020). Due to the uncertainty over the crisis's duration and scope, companies' decision-making became more challenging as they had to assess and balance more factors. This holds at least for the companies that could adapt and react to the changed social and economic environment.

The crisis caused by the COVID-19 pandemic turned attention to various problems and negative trends in companies (Golubeva, 2021; Jesus *et al.*, 2020). Management support, the company's ability to cover expenses, and the motivation and innovativeness of the employees became particularly important during the COVID-19 pandemic (Al-Habaibeh *et al.*, 2021; Santoso *et al.*, 2022).

Companies are expected to consider each possible scenario and adapt to it. The economic and business environment includes an increasingly complex string of pressures and requests from

10.47063/EBTSF.2024.0006
http://hdl.handle.net/20.500.12188/31954

various interest groups, increased expectations regarding corporate social responsibility, and radical uncertainty over future economic conditions (Anas *et al.*, 2023). These factors result in more complex decision-making for managers, questioning the widely accepted management model focused on creating shareholder value.

Well-structured corporate governance adds value to the company as it minimizes the information gap between owners and management and helps align the interests of these stakeholders towards the common objective (Schoenmaker and Schramade, 2023; Stančić, *et al.*, 2012b). It is, therefore, important to differentiate between internal and external mechanisms of corporate governance and their relative importance for shareholders, but also for investors in each stage of the value creation (Affes and Jarboui, 2023). The importance of corporate governance for the financial performance of companies is not studied enough, particularly in developing and/or transition countries, so many authors (Affes and Jarboui, 2023; Bui and Krajcsák, 2024) point to the need for more research on this issue.

The objective of the paper is to examine the impact of the COVID-19 pandemic on the relationship between corporate governance and the financial performance of Serbian companies. Assuming that the whole business world was under a big pressure from the pandemic, and some of the pressure is still evident, the objective was determined to study the relationship between the changed social and economic environment and changes in corporate governance and financial performance. The research covers only non-financial companies operating in Serbia. This research may help to better understand the impact that the COVID-19 pandemic had on Serbian non-financial companies. In addition, as corporate governance assumes a wide variety of elements, the research may emphasize the elements that were changed the most during the COVID-19 pandemic.

This paper may help identify key challenges that companies had to cope with during the COVID-19 pandemic to find the best solutions to overcome these challenges and recover from the negative effects of the COVID-19 pandemic. The paper also emphasizes the strategies that companies may employ to avoid or minimize the consequences of similar crises. Current problems and the available solutions to react to them are therefore analyzed, while we also look for the solutions that may be employed during other similar crises. Specific problems that the pandemic brought require a detailed analysis of corporate governance as an important factor in company survival and development.

Besides the introduction and conclusion, the paper consists of three sections. The theoretical background and results of the prior research are presented in the first section to develop research hypotheses. The second section presents the research methodology, including samples, variables, and research methods. Finally, the research results are presented in the third section.

2. THEORETICAL BACKGROUND AND LITERATURE REVIEW

The separation between company ownership and control led to many theoretical discussions and empirical research on the efficient adjustment of the interests of owners and management. As noted by Pande (2011), Adam Smith started this issue in 1776 arguing that separation between company ownership and control leads to the weak incentives for management to efficiently manage a company. In line with agency theory, agency costs are inevitable to adjust the relationship between owners and management. Companies are the hubs to regulate relationships between different interest groups, which bear the agency costs and have the economic incentive to minimize them (Pande, 2011).

2.1. Ownership and financial performance

Owners control the company in proportion to their share in the equity. The ownership structure may be dispersed or concentrated. The ownership is dispersed when a company has a large number of owners, where each owner does not have control and cannot directly monitor and control management. The main problems of dispersed ownership are the opportunistic behavior of management and well-known agency problems (Nikolić and Babić, 2016). Concentrated ownership assumes that ownership and control are more aligned, thus mitigating agency problems. However, it may lead to many problems such as profit shifting to related-party entities and exploitation of minor shareholders, particularly in weak legal systems (Heracleous and Lan, 2022).

The impact of ownership concentration on financial performance was studied widely in prior research (Guštin Habuš and Prašnikar, 2021; Horobet *et al.*, 2019; Machek and Kubíček, 2018; Stančić *et al.*, 2014; Waheed and Malik, 2019). Abdullah *et al.* (2019) argue that prior research found conflicting interests of stakeholders when the ownership structure is concentrated. On the other hand, owners have less power to control management when the ownership structure is dispersed, which may lead to weak financial performance (Tore, 2017). Pasko *et al.* (2019) also point out the problems that concentrated ownership may bring to investors.

Prior research often studied whether ownership concentration reduces agency costs, i.e. costs of monitoring management (Alkurdi *et al.*, 2021). Concentrated ownership may reduce the conflict of interests between owners and management, thus increasing the financial performance of the company (Guluma, 2021; Mandacı and Gumus, 2010; San *et al.*, 2023). On the other hand, it may deepen agency problems which may reduce company performance (Laporšek *et al.*, 2021). Considering the results of the prior research, we have formulated the first research hypothesis as follows:

H_1: Ownership concentration negatively impacts the financial performance of companies.

2.2. Board of directors and financial performance

The board of directors is often expected to identify chances for company growth and development, but also to minimize or optimize risks that a company faces. Many research studies have found a negative impact of the size of the board of directors on financial performance (Cheng, 2008; Kao *et al.*, 2019; Orozco *et al.*, 2018; Stančić *et al.*, 2012a; Stančić *et al.*, 2014; Yan *et al.*, 2021). It is often emphasized that increasing the number of members on the board to seven or eight reduces the possibility of efficient management control (Tulung and Ramdani, 2018). This is in line with the argument that smaller boards of directors are more efficient in decision-making (Ali, 2018). On the other hand, Orozco *et al.* (2018) find that larger boards of directors may increase the financial performance of companies engaged in different industries.

Topan and Dogan (2014) argue that a larger board of directors' results in increased return on assets and decreased risk of financial distress. They explained such results with the increased efficiency of the decision-making and the fact that directors on larger boards may prioritize the company over personal interests. However, they also find that the size of the board of directors does not significantly impact return on equity and market value. Given the results of prior research, we have formulated the second research hypothesis as follows:

H_2: The size of the board of directors negatively impacts the financial performance of companies.

Non-executive directors are responsible for monitoring the work of executive directors. They are expected to be objective as they are not directly responsible for management functions

(Radović, 2008). They should also express their independent opinion on the business strategies, performance, resources, and behavior standards of a company. They are the core of good corporate governance as they contribute to the development of the relations between owners, other stakeholders, and the whole company, the relations between a company and the market as well as the relations between a company and employees (Alam, 2011). It is, therefore, no surprise that the share of non-executive directors on the board of directors is often found to be positively related to company performance (Khan *et al.*, 2021; Mura, 2007; Muravyev *et al.*, 2016). Given these findings, we have formulated the third research hypothesis as follows:
H_3: Non-executive directors positively impact the financial performance of companies.

2.3. Corporate governance and financial performance during COVID-19 pandemic

The COVID-19 pandemic spread around the world in a very short time, thus considerably impacting the operations and financial performance of most companies, particularly those whose shares are publicly listed. During such a crisis, the board of directors is expected to put higher efforts towards monitoring the management, while remaining highly independent. If managers are endangered or do not work (e.g. if they are infected), the board of directors should be included both in monitoring the management and regular operations of the company (Al Amosh and Khatib, 2023; Nayak *et al.*, 2021).
In the context of pandemics, corporate governance is studied primarily theoretically and mostly in developed countries. Koutoupis *et al.* (2021) emphasize that future research should employ various methodologies and data sources to fully understand the impact of COVID-19 on corporate governance. Prior research also points out that the pandemic questioned the main assumptions of the management model based on the agency theory, thus having important implications for the board of directors (Paine, 2020). It should be also noted that the pandemic crisis offers a unique opportunity to study how different mechanisms of corporate governance influence financial performance (Zattoni and Pugliese, 2021). Considering prior theoretical arguments and the results of some empirical research, we have formulated the fourth research hypothesis as follows:
H_4: The COVID-19 pandemic led to significant changes in the impact of corporate governance on the financial performance of companies.

3. METHODOLOGY

In line with the defined research objective, we hand-collected data for 22 non-financial companies headquartered in Serbia. We retrieved data from the official websites of the Serbian Business Registers Agency and the Belgrade Stock Exchange. Our research covers the period between 2018 and 2022 (a total of 110 observations), thus covering pre-pandemic between 2018 and 2019 (a total of 44 observations) and post-pandemic period between 2020 and 2022 (a total of 66 observations). Such a sample period enables us to identify possible differences in the impact of corporate governance on financial performance under the COVID-19 pandemic.
We employ regression analysis to examine the impact of the COVID-19 pandemic on the relationship between corporate governance and the financial performance of non-financial Serbian companies. Variables employed in the research are presented in Table 1. We measure financial performance with return on total assets (ROA), return on equity (ROE) and Tobin's Q. ROA and ROE are employed as profitability measures, while Tobin's Q is employed as a market value measure. Employed variables enable us to examine whether possible changes in the financial performance of companies may be related to the COVID-19 pandemic.

Table 1: Definitions of variables

Variable	Definition
ROA	Pre-tax income / Total assets
ROE	Pre-tax income / Equity
Q	Market value of equity / Book value of equity
OWN	Share of the largest shareholder in the ownership structure
SIZE	Natural logarithm of the number of directors on the board of directors; for companies with a two-tier board structure, this number includes directors in the supervisory board and executive board
NEX	Share of non-executives on the board of directors
LnTA	Natural logarithm of total assets
Year	Dummy variable for years

Corporate governance variables are ownership concentration or the share of the largest shareholder in the equity (OWN), the natural logarithm of the number of directors in the board of directors (SIZE), and the share of non-executive directors in the board of directors (NEX). Control variables are the natural logarithm of total assets (LnTA) and dummy variables for years (YEAR). This group of variables is employed to study whether specific features of a company and changes in the business environment may explain the impact of the COVID-19 pandemic on the company's success. Therefore, it is possible to examine whether companies with different specific features had different financial performances during the pandemic.

4. RESEARCH RESULTS

4.1. Descriptive statistics

Table 2 presents descriptive statistics for sampled companies, with mean, standard deviation, median, minimum, and maximum values for each dependent, independent, and control variable. Sampled companies considerably differ regarding the size of total assets with a standard deviation of 89.72 billion Serbian dinars. It indicates that the sample is highly heterogeneous in terms of company size. Differences in equity of the sampled companies are considerably smaller. In addition, the mean value of the total assets of the sampled companies is 27.64 billion, while the mean value of the equity is 12.28 billion of Serbian dinars.

Table 2: Descriptive statistics for the period between 2018 and 2022

	Mean	Median	Standard deviation	Minimum	Maximum
ROA (in %)	3.15	3.01	8.76	-34.47	56.56
ROE (in %)	5.39	5.02	23.14	-133.80	146.25
Q	1.14	0.76	1.90	0.08	10.21
OWN (in %)	60.95	64.51	24.37	16.64	100.00
Size of the board of directors	7.23	7.00	2.52	3.00	12.00
SIZE	1.91	1.95	0.38	1.10	2.48
NEX (in %)	55.04	60.00	15.46	25.00	90.91
LnTA	15.34	15.37	1.82	11.02	20.08

Note: The number of observations is 110
(Source: Authors calculations)

It is also important to analyze the sample in terms of ownership structure. The minimum share of the largest shareholder is 16.64%, while the maximum share is 100%. The mean value of this variable is 60.95%. In addition, the average size of the board of directors is 7.23,

though the number of directors varies from three to twelve. The mean value for the share of non-executive directors on the board is around 55%, the minimum value is 25%, and while maximum value is around 91%.
Regarding profitability measures, highly dispersed data may be found for ROE as the difference between mean value and standard deviation is large. On the other hand, considerably lower variability appears for the ROA. A slightly higher ROE than ROA indicates that sampled companies adequately used borrowed sources of financing. Tobin's Q indicates that sampled companies, on average, had slightly higher market value than the replacement cost of assets.

Table 3: Mean values of variables before and after COVID-19 pandemic

Period	2018-2019	2020-2022
ROA (in %)	3.04	3.23
ROE (in %)	5.08	5.59
Q	1.16	1.13
OWN (in %)	58.40	62.65
Size of the board of directors	7.45	7.08
SIZE	1.94	1.89
NEX (in %)	55.04	55.04
LnTA	15.32	15.36

(Source: Authors calculations)

Table 3 presents mean values for independent, dependent, and control variables in the period before (2018-2019) and after (2020-2022) COVID-19 pandemic. Number of observations is 44 for the first and 66 for the second period. A slight increase in the total assets may be identified in the post-pandemic period, which may be due to the increased business activity, but also to inflation. On the other hand, average equity is reduced, indicating lower business certainty and lower guarantee for the creditor's claims.
Both ROA and ROE slightly increased in the post-pandemic period, which may be a result of the increased efficiency and resource allocation towards cost optimization. In general, this may be explained as a part of the adaptation to the challenges brought by the COVID-19 pandemic. For instance, online sales and remote working from the house may be some examples of measures that companies implemented to keep or improve their financial performance. On the other hand, we found a slight decrease in Tobin's Q.
The average share of the largest shareholder in the equity considerably increased in the post-pandemic period. On the other hand, the average size of the board of directors slightly decreased, while the share of non-executive directors in the board remained unchanged. In crisis periods, owners with the largest share in the equity may be motivated to increase their share in a company to increase the control of the company in periods of low share prices. This may be supported not only by the major shareholders but also by the company as a type of adaptation and reaction to the new crisis circumstances. A decrease in the size of the board of directors may be viewed as a tendency towards more efficient decision-making and adjusting the interests of stakeholders in light of challenges brought by modified economic circumstances.

4.2. Regression estimates

The results of the regression analysis are presented in Table 4. It appears that the increase in the ownership concentration significantly reduces company profitability in the whole sampling period. Since such influence is statistically significant only in the pre-pandemic, but not in the post-pandemic period, it may be concluded that the COVID-19 pandemic brought important differences regarding the impact of ownership concentration on profitability. In other words, an increase in the share of the largest shareholder during the COVID-19 pandemic did not have a significant negative impact on profitability. Such results may be explained by the increased importance of the largest shareholder for more efficient decision-making and overcoming crises. Additionally, the ownership concentration significantly and positively impacts Tobin's Q during the whole sampling period and also during both sub-periods, implying that the market positively values companies listed on the Belgrade Stock Exchange whose ownership is highly concentrated.

Regarding the size of the board of directors, regression results suggest that it negatively impacts the profitability measured by ROA in the whole sampling period and the pre-pandemic period. However, the size of the board of directors does not have a significant impact on ROA in the post-pandemic period. This implies that the size of the board of directors lost significance due to the COVID-19 pandemic. Additionally, the size of the board of directors does not have a significant impact on ROE and Tobin's Q neither in the whole sampling period, pre-pandemic or post-pandemic period.

Table 4: Regression estimates

	2018 - 2022			2018 – 2019			2020 - 2022		
	ROA	ROE	Q	ROA	ROE	Q	ROA	ROE	Q
Const.	-0.055 (-0.764)	-0.397** (-2.096)	0.154 (0.109)	-0.025 (-0.355)	-0.151 (-0.997)	0.570 (3.099)	-0.079 (-0.694)	-0.570* (-1.876)	-0.257 (-0.134)
OWN	-0.237** (-2.232)	-0.193* (-1.827)	0.480*** (4.994)	-0.337** (-2.215)	-0.279* (-1.773)	0.456*** (3.099)	-0.194 (-1.308)	-0.176 (-1.218)	0.517*** (3.889)
SIZE	-0.252** (-2.016)	-0.021 (-0.166)	-0.063 (-0.559)	-0.452** (-2.391)	-0.210 (-1.027)	-0.130 (-0.712)	-0.178 (-1.059)	0.038 (0.233)	-0.016 (-0.106)
NEX	-0.083 (-0.704)	0.043 (0.364)	-0.408*** (-3.815)	0.041 (0.230)	0.140 (0.757)	-0.381** (-2.194)	-0.134 (-0.848)	0.025 (0.165)	-0.439*** (-3.100)
LnTA	0.371*** (2.700)	0.282** (2.064)	0.129 (1.034)	0.462** (2.150)	0.343 (1.544)	0.143 (0.688)	0.348* (1.938)	0.281 (1.606)	0.123 (0.763)
YEAR	Yes	Yes	Yes	No	No	No	No	No	No
Adj. R^2	0.058	0.071	0.228	0.138	0.080	0.193	0.017	0.063	0.211
F-value	2.671**	3.090**	9.045***	2.715**	1.932	3.579**	1.289	2.094*	5.335*
Obs.	110	110	110	44	44	44	66	66	66

Note: statistically significant at 5% (**) and 1% (***)
(Source: Authors calculations)

The impact of the share of non-executive directors in the board on the profitability is not significant in any observed period. On the other hand, this independent variable has a significant negative impact on Tobin's Q in each observed period. This implies that an increase in the share of non-executive directors does not contribute to the company's profitability, while negatively impacting its market value. Such findings may be explained by the weak non-executive directors who are not able to influence the behaviour of management. In addition, when the ownership concentration is high, the real power of non-executive directors may be relatively small, particularly if the largest shareholders directly influence the decision-making in a company.

5. DISCUSSION AND CONCLUSION

The objective of the paper was to examine the impact of the COVID-19 pandemic on the relationship between corporate governance and the financial performance of companies. The research was conducted on 22 non-financial companies headquartered in Serbia and listed on the Belgrade Stock Exchange between 2018 and 2022. The data were retrieved from the official websites of the Serbian Business Registers Agency and the Belgrade Stock Exchange. Research results suggest that the ownership concentration is negatively related to profitability and positively to market value. On the other hand, they show the negative impact of the size of the board of directors on the profitability and the negative impact of the share of non-executive directors in the board on the market value of companies. The results also suggest that the COVID-19 pandemic impacted the relationship between corporate governance and financial performance, so the impact of corporate governance on financial performance was more significant in the pre-pandemic period.

This paper suggests that corporate governance has a certain role in shaping the financial performance of Serbian companies. Lo and Shekhar (2018) identified the positive impact of corporate governance on the financial performance of German companies in the pre-pandemic period, while O'Sullivan and Carroll (2021) found a positive impact of corporate governance on the financial performance of companies in the United Kingdom. In this regard, the results of the present research add to the prior research results, confirming the importance of corporate governance for achieving satisfying financial performance, both before and after the COVID-19 pandemic.

The paper contributes to the relatively scarce literature on the impact of the COVID-19 pandemic on business activity. It explains how the crisis affected business operations and decision-making. It is clear that more research is needed, particularly longitudinal ones. Regarding the practical implications, the results may be of interest to companies striving to implement solutions that are useful to overcome crises and increase profitability and market value. Managers may better understand to which elements of corporate governance they should pay more attention. In addition, they may better understand the changes that the COVID-19 pandemic brought to their companies. Public policymakers may benefit from the research results to create policies that are adjusted to the current social and economic environment.

Although the research explains the impact of the COVID-19 pandemic on the relationship between corporate governance and financial performance, it should be considered in light of certain limitations. The research finds that the relationship between corporate governance and financial performance exists but does not clearly identify the causality. In fact, financial performance may also significantly affect key features of corporate governance. Additionally, the research was conducted in a specific context and only on publicly listed companies. It is possible that the research in a different context and with other types of companies would yield different results. The research also could not cover each effect brought by the pandemic. It is, therefore, necessary to track the changes in corporate governance and financial performance in future years, to understand whether changes brought about by the COVID-19 pandemic are present only in the short run.

Future research should avoid the mentioned limitations to yield more reliable results and check the results of this research. The sample in our research is representative, though relatively small, while the sampling period is relatively short. Future research should employ a larger sample, consisting of companies from other transition neighbouring countries and covering a longer period. Using financial data from well-known databases and employing more variables may contribute to the reliability of the empirical results. Future research may also consider using other statistical methodologies.

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