Research Article

The Impact of Corporate Governance on Company Performance: A Study among Medium and Large Enterprises in Kosovo

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Abstract

An effective corporate governance system is established to ensure proper balance of long-term interests of different stakeholders (primarily: owners, employees and management) and improve company's performance and its competitive position in the market. This paper provides a theoretical discussion and empirical evidence on the interdependence between corporate governance and company performance among medium and large enterprises in Kosovo. A questionnaire survey was employed for data collection purposes. The study included a sample of 87 managers from 87 medium and large enterprises. Results indicate that effects of corporate governance on the performance tend to be greater in larger companies. Regarding the determinants, the theoretical expectations are confirmed. Results confirm that the size of the company, the level of investment, export activities and company life expectancy are statistically significant determinants of the adoption of corporate governance practices. As a result, larger companies with large scales of investment and longer market experience tend to adopt more corporate governance practices. The study suggests that corporate governance will inevitably affect companies' performance and further research is needed in this context.

Keywords: *Performance, corporate governance, company, enterprise*

1. Introduction

Promoting sound principles of corporate governance has become a global issue for advancing governance and performance of private and public businesses. The importance of corporate governance throughout its overall governance chain including not only key stakeholders (owners, employees and managers) but also institutional investors, stock exchanges, brokers, and conflict of interest is undebatable. This approach has certainly grown under the influence of the financial crisis that began in 2008. The vast majority of literature considers the problems of corporate governance and conflict of interest in the investment chain to be the main sources of reference. Although, as outlined in the recommendations of the Organization of Economic Cooperation and Development (OECD) derived from its meeting in Ankara (2015), that corporate governance principles are more relevant to larger companies than small ones, it is highly recommended to increase the awareness that corporate governance principles apply to all companies.

2. Literature Review

The prominence of corporate governance on organizations setting mainly developed in the second half of the last century. Llaci (2012), informs that reforms on corporate governance are found in 20th century, whilst in 1930 a miss management of corporate governance was noticed. As a result, in 1934 reforms which regulated ownership and governance were approved in the US. Corporate governance gained importance in particular after 2002 when major companies such as Enron, Tyco, Adelphia WorldCom and Global Crossing were accompanied by major governance scandals (Monks and Minow, 2004). Similarly, in the UK the report of Robert Smith and Higgs (2003) was presented which stipulated efforts to increase effectivity and transparency of auditing (Solomon, 2004).

The main function of corporate governed, Cudbury Report, UKSHA (1992), argues is to govern and control companies through which it makes the board of directors responsible for company governance while retains shareholders responsible to elect members of board of directors and auditors. Thus, relationship between owners and managers is built upon the effective implementation of contracts (Jensen & Meckling, 1976; Hill & Jones, 1992; Hart, 1995).

For Arjoon (2005), corporate governance is a mechanism which ensures interest of shareholders are in accordance not only with their own interest but other stakeholders as well. An effective governance of companies in turn, leads to effective and efficient offerings of products and services (Siebens, 2002). The importance of technology cannot be ignored also. According to Brandas (2011) technology is a key component which supports reduction of information asymmetry in particular. Research provides further evidence that investors prefer to invest in companies which employ effective corporate governance (Bushee, Carter & Gerakos, 2014, Leuz, Lins & Warnock, 2007, Todorovic, 2013).

Gompers, et al. (2003), based on a research among 1500 American companies found a positive correlation between good corporate governance and company’s value. Likewise, Bebchuk, et al. (2004), report a significant relationship between governance indicators, company value and shareholders return.

Companies that follow corporate governance practices benefit through better access to capital and steady increment of investment by ensuring necessary sustainability in their operations. To achieve this goal and ensure better link between quality of corporate governance and its performance, a system of indicators for performance appraisal and measurement needs to be developed. According to Mitchelberger (2017), studies that test the interrelation between corporate governance and company performance regularly test three performance parameters: (1) increase in revenue or sales as an indicator of market management success and in some way also of employees as it generates jobs and salaries; (2) Return on Investment Capital (ROIC) that expresses management's ability to successfully allocate assets and capital; (3) Total Return of Shareholders, which indicates the level of compliance of shareholders with the management.

The company's performance measurement has to show in fact that management is leading the company effectively and efficiently in terms of performance on the market while also ensuring that the value of assets and the share value of shareholders is increasing. While some indicators of market success and company success are quite standardized, the quality standards for corporate governance are not standardized and they are much more difficult to measure. In this context, Berghe (2013), points out that each country on the basis of its specifications should define or codify the standards of corporate governance. Based on a broad analysis of literature, he concludes that board independence, board compensation, board size, the frequency of board meetings, and the number of board committees are taken as variables to test their impact on the performance of the company.

However, Delmar (1997; 2003) finds that turnover, sales and revenues are the most commonly (30%) used indicators in performance measurement followed by the number of employees (29%). Wiklund and Shepherd (2009), also point out that 60% of firm performance studies apply revenue growth, respectively sales, while employment growth is used by about 12%; Approximately 14% use standard financial indicators that measure profit such as profitability coefficients in relation to assets, investments or sales (see also Berger, 2017).

There is a significant number of studies on impacts of corporate governance on the performance of enterprises across different countries. Armitava (2016) for instance, finds that five of the 25 listed good corporate governance indicators have a significant impact on financial indicators (ROE and market value of companies) at a panel of 58 Indian corporations listed on the stock exchange. This is in the line with the findings of Jere, Khurana, and Pereira (2005) in the Latin American case where they concluded that there is a link between transparency and quality of corporate governance in performance expressed through ROA and their credibility for access in credit (credit rating). In the case of Central and Eastern Europe, such evidence is provided by the Bistrova and Lace (2012), who based on a model that included 21 features of corporate governance, concluded that 25% of the companies with the best characteristics of corporate governance significantly exceed performance of 25% of companies at the bottom of the list in terms of attractiveness, investment access and risk management. Similarly, in the case of Croatia, Kokotec, Čalopa and Detelj (2017), in a sample that included a number of companies listed on the Croatian Stock Exchange found a relevance of the best ranking for companies in terms of the corporate governance index for successful business performance.

The study of Dincer and Oguz (2016), involving 90 companies listed in a stock exchange concluded that during 2008-2014 evidence showed that elements of corporate governance such as board size, composition, number of board committees, and duality in top manager position have an impact on performance expressed through ROA, ROE and financial sustainability. Keasy and Wight (1993) found that corporate governance provided successful operation of companies.

One of the controversial aspects of corporate governance however, is the linking of wages (salaries) to board members and chief executive managers to the company's long-term goals and interests and its owners. In this regard, it is suggested that the pay and salary policy is linked to performance indicators that are valued with measurable standards and indicators. Some companies have developed the practice of creating a committee (special committee) to pursue the reward policy, in the composition of which are the non-executive (independent) members of the Board as a way of overcoming the conflict of interest in this area (OECD, 2015).

3. Methodology

The study included medium and large companies in Kosovo as they are of utmost importance for economic growth of the country. In general terms, enterprises employing between 50 and 249 employees are regarded as medium enterprises, while enterprises with more than 250 employees are considered as large enterprises for the purpose of this research. Irrespective of their classification, both are constantly faced with a challenging business environment but continue to survive for over 15 years. To collect data, a structured questionnaire was developed using Kolbotolbox programme. A total of 140 companies were randomly selected based on the sample of a registry of the Tax Administration of Kosovo. The questionnaire was electronically disseminated to 140 managers whilst to ensure higher response rate, researchers followed-up with respondents two weeks after dissemination. The follow up included reminding respondents through email while a week later they were contacted through the telephone. The data collection lasted for 3 months, from June to August 2017 respectively. The survey was completed by 87 managers thus, resulting in a 62% response rate which was deemed statistically sufficient for data analysis.

Table below shows the sample of companies included in the study classified according to their legal entity status.

Table 1: Legal status of companies

Business type	Number	%
Individual businesses	12	14
Partnerships	2	2
LTD companies	62	72
Shareholder companies	9	10
Other	2	2
Total	87	100

Source: Compiled by authors

4. Findings and Discussion

Research results confirm that development of Corporate Governance according to the international standards, especially OECD principles in the case of medium and large private companies in Kosovo is in its early stage with only less than half (47.5%) of companies having established Boards of Directors. Surprisingly 37% of LTD companies and 30% of shareholder companies do not possess BoD as depicted below:

Table 2: The presence of BoD at companies

Individual businesses	33%
Partnerships	50%
LTD companies	37%
Shareholder companies	70%
Other	-
Total	47.5%

Source: Compiled by authors

The structure and composition of the boards also, neither comply with principles nor does adequately contribute to proper balance of different stakeholders through separation of ownership from managerial functions and avoidance of conflicts of interests. Owners have heavy presence in the BoD structure at all (100%) of companies that have boards. The same is true with Executive Director in 70% of companies. On the other side, independent experts and employees are only present in 25% and 5% of companies respectively. In only 22% of cases Executive director is nominated by the BoD, whilst in others simply family route is followed (Table 3 and 4).

Table 3: The Structure of BoD: % of companies

Owners	100%
Independent experts	25%
Employees	5%
Executive Director is member of BoD	70%

Table 4: The Election of Executive Directors (ED)

ED is nominated by the Board/ shareholders	22%
ED is originating from family members	79%

The above data clearly show that there is heavy interference in functions of ownership, governance and management. This is a crucial issue for further growth of these companies (their investment attractiveness in particular) and even risk to face inheritance and change of generation in ownership and management in their future.

In terms of impact of presence of BoD in company performance, despite all deficiencies described above, companies with BoD demonstrate better performance in sales, investment and exports respectively. As shown on table 5, companies with BoD have higher average sales per company for about 40%, except in 2016 (30%). Likewise companies with BoD have 12%-19% higher average investment per company, except in 2016; half (50%) of companies with BoD tend to be exporters unlike only 27% of those without BoD. The share of exports in sales count for 5% higher at companies with BoD.

Table 5: Average Sales, Investment, exports and Presence of BoD

Presence of BoD	**Sales (000 Euros)**			**Investment (000 Euros)**			**Exports (%)**
Year	**2014**	**2015**	**2016**	**2014**	**2015**	**2016**	**2016**
Companies with BoD	1,911	1,499	2,020	1,305	1,223	988	50
Companies without BoD	1,355	1,136	1,538	1,163	942	1,147	27

Although data for sales in investment are only for three years (2014-2016) and it is difficult to evaluate trends in terms of growth of sales and investment, results show that annual growth rates are slowing at companies with BoD. This might be influenced by the fact that smaller companies usually have higher growth rates in sales and investment as opposed to larger companies due to diminishing effects but also it might be affected by inadequate developments in governance structures and undeveloped BoD structure and operations. This needs to be further explored as it represents a limitation of this paper.

5. Conclusion

The study aimed to analyze effects of corporate governance on company performance based on a sample of 87 medium and large enterprises in Kosovo context. Results indicate that current situation with heavy presence of owners and Executive directors does not ensure proper balance of interests of different stakeholders and avoidance of conflict of interest. The proper relations in corporate governance chain at medium and large private companies in Kosovo still needs to be established and developed. The structure of BoD should significantly be improved through radical increase of the number of independent experts in the Board of Directors and involvement of higher number of employees and other relevant stakeholders. Companies with established boards show better performance in sales, investment and exports compared to companies that do not have the established BoD, but it seems that this would have been much more evident and sustainable without deficiencies that are associated with current structures and practices in corporate governance of these companies.

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