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A STUDY ON THE RELATIONSHIP BETWEEN CORPORATE GOVERNANCE AND FINANCIAL PERFORMANCE FROM THE PERSPECTIVE ON ENTERPRISE SUCCESSOR SELECTION

Corporate managers play a critical role in corporate governance and financial performance, and continuing the development of corporate governance and financial performance becomes an important consideration in selecting enterprise successors. The past research mostly focused on the discussions between corporate governance and financial performance, but not from the perspective on enterprise successor selection. For this reason, the relationship between corporate governance, financial performance, and enterprise successor selection is discussed in this study. The research outcomes conclude that: 1. Corporate governance presents significantly positive effects on financial performance, 2. Enterprise successor selection has remarkably positive effect on corporate governance, 3. Enterprise successor selection shows notably positive effect on financial performance, and 4. Enterprise successor selection reveals remarkably moderating effect on the relationship between corporate governance and financial performance. Consequently, it is suggested to take enterprise successor selection into account when developing corporate governance and financial performance strategies.

Keywords: *successors; corporate governance; financial performance; board of directors; return on sales.*

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ДОСЛІДЖЕННЯ ЗАЛЕЖНОСТІ МІЖ КОРПОРАТИВНИМ УПРАВЛІННЯМ І ФІНАНСОВИМИ ПОКАЗНИКАМИ З ТОЧКИ ЗОРУ ВИБОРУ НАСТУПНИКА В УПРАВЛІННІ

У статті стверджується, що корпоративні менеджери грають важливу роль в управлінні організацією і фінансових показниках. Продовження розвитку управління організацією і фінансовими показниками є важливим аргументом при виборі корпоративного наступника. Йдеться про залежності між управлінням організацією, фінансовими показниками і вибором корпоративного наступника. Результати показують, що: 1) управління організацією має значний позитивний ефект на фінансові показники; 2) вибір корпоративного наступника має помітний позитивний ефект на управління організацією; 3) вибір корпоративного наступника демонструє помітний позитивний ефект на фінансові показники; 4) вибір наступника має помітний пом'якшувальний ефект на стосунки між управлінням організацією і фінансовими показниками. Відповідно, запропоновано враховувати вибір наступника при розробці стратегій управління організацією і фінансовими показниками.

Ключові слова: *наступники; управління організацією; фінансові показники; рада директорів; рентабельність продажів.*

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ИССЛЕДОВАНИЕ ЗАВИСИМОСТИ МЕЖДУ КОРПОРАТИВНЫМ УПРАВЛЕНИЕМ И ФИНАНСОВЫМИ ПОКАЗАТЕЛЯМИ С ТОЧКИ ЗРЕНИЯ ВЫБОРА ПРЕЕМНИКА В УПРАВЛЕНИИ

В статье утверждается, что корпоративные менеджеры играют важную роль в управлении организацией и финансовыми показателями. Продолжение развития управления организацией и финансовыми показателями является важным аргументом при выборе корпоративного преемника. Поэтому в данной статье речь идет о зависимости между управлением организацией, финансовыми показателями и выбором корпоративного преемника. Результаты показывают, что: 1) управление организацией имеет значительно положительный эффект на финансовые показатели; 2) выбор корпоративного преемника имеет заметно положительный эффект на управление организацией; 3) выбор преемника демонстрирует заметно положительный эффект на финансовые показатели; 4) выбор корпоративного преемника имеет заметно смягчающий эффект на отношения между управлением организацией и финансовыми показателями. Соответственно, предложено учитывать выбор преемника при разработке управления организацией и финансовыми показателями.

Ключевые слова: *преемники; управление организацией; финансовые показатели; совет директоров; рентабельность продаж.*

Introduction. Effective corporate governance performs differently according to the growth phase and the number of employees in a company. Research (Adams and Ferreira, 2007; Song and Thakor, 2006) indicated that enterprise successor selection could affect the quality of acquirable information for board of directors and investors; strong board of directors is likely to strictly evaluate the enterprise successor selection for an optimal choice. According to the survey by USA Today on August, 22nd, 2007, most enterprises whose founders still served as the chief executive officer (CEO) demonstrated excellent performance; some of them even accomplished more than 60-time stock prices in the past 15 years. The key in a successful company lies in the enterprise successor deeply understanding the industry to clearly realize the needs of a company for key reform. A lot of companies, established before the emergence of Internet, like "FedEx", "Dell Computers", and "Apple", are heavy users of the Internet. Besides, personal wealth of many enterprise successors is closely related to the stock price, such as Larry Ellison holds up to 1.3 bln. shares of "Oracle", which is about US$ 25 bln. at the market. In this case, such corporate managers concern more of stock prices, rather than their salaries. Apparently, corporate managers present great responsibility for corporate governance and financial performance. Nevertheless, they would leave the office one day. How a new successor continuing the development of corporate governance and financial performance becomes the primary consideration in selecting enterprise successors. However, most of the past research focused on the discussion of corporate governance and financial performance, but not from the perspective on enterprise successor selection. This study therefore tends to discuss the causality between enterprise successor selection, corporate governance, and financial performance to understand the interaction between corporate governance and financial performance and to look for the key factors in the enterprises selecting successors.

Literature Review.

1. Corporate Governance. Brealey and Myers (2000) regarded corporate governance as company control, i.e., formulating the power of decision-making on investment and finance. Generally, corporate governance covers the roles of directors in board of directors, voting rights of shareholders, proxy fight, and the actions of other shareholders which could affect the decision-making. Lee (2009) studied the relationship between corporate governance and corporate value with the latent variables in the structural equation model. The research samples were the listing companies in 2003-2007, and the variables for corporate governance contained manager ownership, equity pledge ratio of directors and supervisors, managers holding a concurrent post in directors, and Big 4 CPA firms-audited certification. Hsu (2009) attempted to establish the integrated dimension for corporate governance to verify the effect on operating efficiency and corporate value. With the variables of information transparency, directors and supervisors ownership, organizations ownership, manager ownership, equity pledge ratio of directors and supervisors, director holding a concurrent post in CEO, board of directors size, proportion of independent directors and supervisors, and reward proportion of directors and supervisors, the data envelopment analysis was utilized. Hsu (2010) studied the relationship between corporate governance and corporate performance of the 106 listed companies within 2003-2008. The variables of equity structure of shareholders and board of director structure and high-level managers for corporate governance were analyzed with the fixed effect model. The dimensions of number of independent external directors, manager ownership, director and supervisor ownership, larger shareholder ownership, and decision-making power of CEO, proposed by Lo & Wong and Firth (2010) for corporate governance, were applied in this study.

2. Financial Performance. The measurement of financial performance is based on finance, which is a tool to evaluate corporate performance (Gasbarro and Zumwalt, 2002). Venkatraman & Ramanujam (1986) divided organizational performance into financial performance and operating performance. The former was measured by the rate of economic fulfillment based on the output of financial index, including sales growth, return on investment, and earnings per share; the latter, or non-financial performance, was the technical evaluation index of efficiency, such as market shares, introduction of new products, product quality, and the creation of value-added.

Papp (1999) divided financial index into return on investment (ROI), return on sales, gross profit, cash flow rate, earnings per share, return on equity, income growth, and sales growth. Lynch et al. (2000) contained net profit margin, return on assets (ROA), return on investment (ROI), overall competitive status, and general profit rate in financial index. Pelham (2000) divided profit rate into return on equity (ROE), gross profit rate, and return on investment (ROI). There were several standards for evaluating the financial index. According to the research subject and coverage, single concept could also be applied, such as return on assets (ROA), return on sales (ROS), return on equity (ROE), and sales growth (Ramaswamy et al., 1996). This study therefore applied return on sales as the dimension for financial performance.

3. Enterprise Successor Selection. The research of Center for Creativity Leadership revealed that 65% externally employed high-level managers were likely to fail in the first 2 years (Berchelman, 2005), showing that such talents could not bring the professions into play because of not understanding the organizational culture. Friedman and Olk (2004) studied the succession of CEO in organizations from the dimensions of present chief executive officer-guided succession and preselected candidates or standards and concluded 4 types of the CEO succession.

(1) Crown heir. Such a succession model is guided by present CEO and suitable candidates have been preselected. Present CEO shows the hegemony on such a succession model, and the external world has sufficient information of the successors. (2) Horse race. Present CEO guided such a succession model, but without preselected candidates. Horse race refers to some candidates being mixed in the options for successor selection, but CEO controls the final decision. (3) Coup d'Etat. The succession model is not guided by present CEO, but with suitable candidates being preselected. It is named Coup d'Etat because of the dissatisfaction with present CEO and the attempt to get away from the control of the present CEO. (4) Comprehensive search. The succession model is not guided by present CEO and no candidate is preselected. The comprehensive search for successor is similar to Coup d'Etat, as some people in an enterprise expect present CEO being replaced; the selection is broader and systematic, but interested candidates should correspond to various standards.

4. Relationship among Enterprise Successor Selection, Corporate Governance, and Financial Performance. Jensen & Meckling (1976) regarded one of the major objectives of corporate governance being to provide shareholders with a favorable return on investment. However, shareholders in most limited companies would authorize the control and strategic decisions to managers so that the corporate governor becomes the agent of shareholders. Being the agent of shareholders, the person should pursue permanent return for shareholders. A lot of past research discussed the effects of corporate governance on financial performance and proved that favorable corporate governance could enhance financial performance of a company (Agrawal and Knoeber, 1996; Black et al., 2006; Bai et al., 2004; Cheng, 2008) or reduce capital costs (Ashbaugh et al., 2004; Cheng et al., 2006). Nonetheless, in spite that a favorable corporate governance could directly affect financial performance, it could manage the organizational behaviors through enterprise successor selection. Several studies have proved the effectiveness of enterprise successor selection (internal monitoring mechanism). Some research also indicated that corporate performance would be significantly improved when new high-level managers are selected externally (Khurana and Nohria, 2002). These studies show that effective corporate governance allow enhancing financial performance of a company, but enterprise successor selection could affect the effectiveness of corporate governance. According to the literature, enterprise successor selection showed positive relationship with corporate governance and financial performance (Denis et al., 1997). Although Jensen and Meckling (1976) pointed out the ownership of managers being beneficial for the consistency between managers and shareholders, recent research also found that favorable enterprise successor selection could present positive relationship between corporate governance and financial performance. As a consequence, enterprise successor selection has critical relations with corporate governance and financial performance.

Based on the above statements, the following hypotheses are proposed in this study.

Hypothesis 1 (H1): Corporate governance presents significantly positive effects on financial performance.

Hypothesis 2 (H2): Enterprise successor selection demonstrates remarkably positive effects on corporate governance.

Hypothesis 3 (H3): Enterprise successor selection shows notably positive effects on financial performance.

Hypothesis 4 (H4): Enterprise successor selection reveals moderating effects on corporate governance and financial performance.

Research method.

1. Research framework. According to the literature review, it was regarded that there are correlations between corporate governance, financial performance, and enterprise successor selection. The proposed framework is shown in Figure 1.

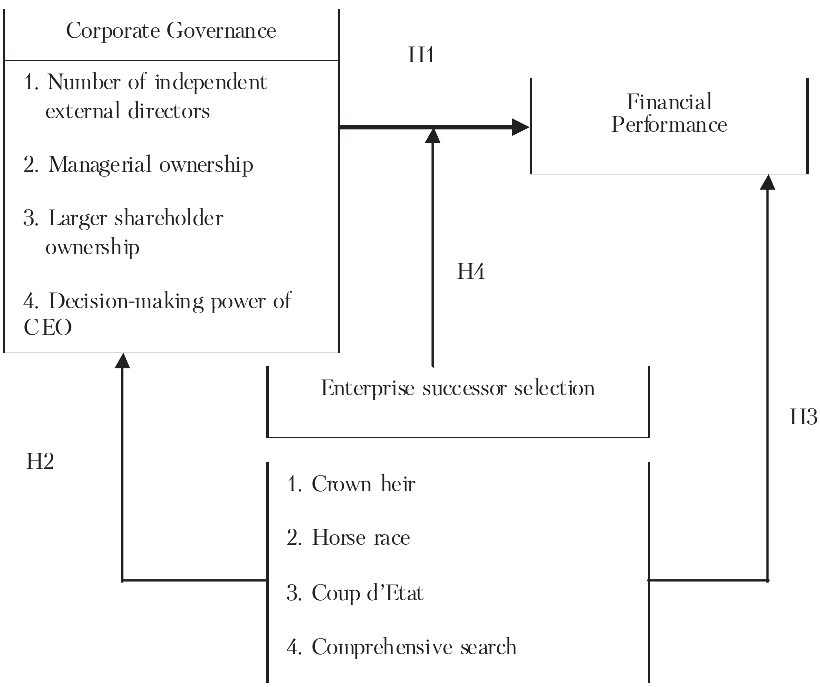

Figure 1. **Research framework**

2. Sampling and sample analyses. With random sampling, the questionnaires were distributed and collected through post. Cheng Shin Rubber Ind. Co., Ltd., one of the top-10 tire brands in the world, has established 5 manufacturing factories in Changhua County, Taiwan, invested in the factories in China, Thailand, and Vietnam, and established branches in the USA, Canada, Germany, Japan, and the Netherlands as an internationalized enterprise. The turnover and export stand on the top of tire industry in Taiwan. Having technical cooperation with TOYO Tires, the brands of Cheng Shin, CST, and MAXXIS are marketed globally, in which MAXXIS was selected as Branding Taiwan Top 20 for 7 years by 2009. For this reason, the enterprise succession candidates of Cheng Shin Rubber Ind. Co., Ltd., the high-level managers, and professors were selected as the research subjects. Total 210 questionnaires were distributed, and 134 valid copies were retrieved, with the retrieval rate of 64%. Each retrieved questionnaire was regarded as an effective sample.

Research outcomes and analyses.

I. Reliability and validity analyses.

1. Corporate Governance Scale. Based on the definition and types proposed by Lo, Wong & Firth (2010), questions for corporate governance were designed. With factor analysis, 4 factors in corporate governance were extracted, as a number of independent external directors (eigen value=1.888, α=0.74), manager ownership (eigen value=1.651, α=0.78), larger shareholder ownership (eigen value=1.549, α=0.67), and decision-making power of CEO (eigen value=1.257, α=0.67). The common cumulative variance explained achieved 79.316%.

2. Financial Performance Scale. Referring to Ramaswamy et al. (1996), a single dimension, return on sales, was applied to the financial performance.

3. Enterprise Successor Selection Scale. The questionnaire design of enterprise successor selection was revised from the one proposed by Friedman and Olk (2004). With factor analysis, 4 factors were extracted for the enterprise successor selection scale, including: crown heir (eigen value=1.956, α=0.70), horse race (eigen value=1.641, α=0.60), coup d'Etat (eigen value=1.369, α=0.80), and comprehensive search (eigen value=1.227, α=0.68). The common cumulative variance of the 4 factors reached 77.403%.

II. Regression relation among variables.

1. Multiple Regression Analysis of Corporate Governance and Financial Performance. Multiple regression analysis results of financial performance towards corporate governance are organized in Table 1.

Table 1. **Multiple Regression Analysis of Financial Performance towards Corporate Governance**

Independent variable	Financial Performance (Dependent variable)
Corporate Governance	
Number of independent external directors	0.229**
Manager ownership	0.217**
Larger shareholder ownership	0.282**
Decision-making power of CEO	0.298***
F	8.718
Significance	0.000***
R^2	0.213
Regulated R^2	0.188
*p <0.05 **p <0.01 ***p <0.001	

Data source: Self-sorted in the study.

The regression equation achieved significance (F=8.718, p<0.001). Corporate governance presented remarkable correlations with financial performance, where number of independent external directors, manager ownership, larger shareholder ownership, and decision-making power of CEO for corporate governance showed significantly positive effects on product market share for financial performance and reached significance (β=0.229, p<0.01; β=0.217, p<0.01; β=0.282, p<0.01; β=0.298, p<0.001). H1, therefore, was agreed.

2. Multiple Regression Analysis of Enterprise Successor Selection towards Corporate Governance. Multiple regression analysis results of enterprise successor selection towards corporate governance are listed in Table 2.

Table 2. **Multiple Regression Analysis of Enterprise Successor Selection towards Corporate Governance**

Independent variable	Corporate Governance (Dependent variable)			
	Number of independent external directors	Manager ownership	Larger shareholder ownership	Decision-making power of CEO
Enterprise Successor Selection				
Crown heir	0.758***	-0.055	-0.015	-0.052
Horse race	0.078	0.770***	0.024	0.075
Coup d'Etat	-0.022	-0.019	0.779***	0.029
Comprehensive search	-0.015	-0.039	0.050	0.767***
F	41.607	50.561	47.309	47.760
Significance	0.000***	0.000***	0.001***	0.000***
R^2	0.563	0.611	0.595	0.597
Regulated R^2	0.550	0.598	0.582	0.584
*p<0.05 **p<0.01 ***p<0.001				

Data source: Self-sorted in the study.

The regression equation reached significance (F=41.607, p<0.001). Enterprise successor selection revealed notably positive effects on the number of independent external directors for corporate governance, and crown heir presented significantly positive effects on the number of independent external directors (β=0.758, p<0.001).

The regression equation achieve significance (F=50.561, p<0.001). Enterprise successor selection showed remarkably positive effects on manager ownership for corporate governance, and horse race showed notably positive effects on manager ownership (β=0.770, p<0.001).

The regression equation reached significance (F=47.309, p<0.001). Enterprise successor selection showed remarkably positive effects on larger shareholder ownership for corporate governance, and coup d'etat presented significantly positive effects on larger shareholder ownership (β=0.779, p<0.001).

The regression equation reached significance (F=47.760, p<0.001), showing notably positive effects of enterprise successor selection on decision-making power of CEO for corporate governance and significantly positive effects of comprehensive search on decision-making power of CEO (β=0.767, p<0.001).

Enterprise successor selection revealed notably positive effects on corporate governance, H2 was partly agreed.

3. Multiple Regression Analysis of Enterprise Successor Selection and Financial Performance. Multiple regression analysis results of enterprise successor selection towards financial performance are sorted in Table 3.

Table 3. **Multiple Regression Analysis of Enterprise Successor Selection towards Financial Performance**

Independent variable	Financial Performance (Dependent variable)
Enterprise Successor Selection	
Crown heir	0.198**
Horse race	0.277**
Coup d'Etat	0.232**
Comprehensive search	0.288***
F	8.302
Significance	0.000***
R^2	0.205
Regulated R^2	0.180
*p<0.05 **p<0.01 ***p<0.001	

Data source: Self-sorted in the study.

The regression equation achieved significance (F=8.302, p<0.001), presenting remarkably positive effects of enterprise successor selection on financial performance, in which crown heir, horse race, coup d'etat, and comprehensive search showed notably positive effects on product market share (β=0.198, p<0.01; β=0.277, p<0.01; β=0.232, p<0.01; β=0.288, p<0.001). H3, therefore was agreed.

III. The effects of the interaction between corporate governance and enterprise successor selection on financial performance.

1. The moderating effects of corporate governance and enterprise successor selection on financial performance. With the interactions between numbers of independent external directors, manager ownership, larger shareholder ownership, decision-making power of CEO for corporate governance and crown heir, horse race, coup d'etat, and comprehensive search for enterprise successor selection, the effects on financial performance are shown in Table 4.

From the regression analysis, the dimensions for corporate governance could explain 21.3% variance of financial performance before inputting in the independent variable of enterprise successor selection. The overall test of multiple linear regression F=8.718 (p<0.001) achieved significance, presenting notably positive effects of corporate governance on financial performance. After inputting the independent variables of enterprise successor selection in the regression model, the overall variance explained increased 2.5%, F=4.892 (p<0.001) reaching significance. Overall, both corporate governance and enterprise successor selection revealed significantly positive effects on financial performance, and the variance explained 23.8% was increased obviously. Worth noting, number of independent external directors, manager ownership, larger shareholder ownership, and decision-making power of CEO for corporate governance showed remarkably positive effects on financial performance before inputting enterprise successor selection, but the significance reduced after inputting the dimensions for enterprise successor selection.

The overall variance explained was also increased after inputting the interactions between corporate governance and enterprise successor selection. Within the interactive items, the interactions between larger shareholder ownership and coup d'etat showed notably negative effects on financial performance (β=-1.213, p<0.01), H4 was partly agreed.

Table 4. **Hierarchical Regression Analysis of Corporate Governance and Enterprise Successor Selection towards Financial Performance**

Hierarchical variable	Financial Performance (Dependent variable)		
	Hierarchy I	Hierarchy II	Hierarchy III
Corporate Governance			
Number of independent external directors	0.229**	0.146	-0.196
Manager ownership	0.217**	0.040	-0.262
Larger shareholder ownership	0.282**	0.216	-0.838
Decision-making power of CEO	0.298***	0.140	0.695
Enterprise successor selection:			
Crown heir		0.100	0.485
Horse race		0.219	0.133
Coup d'Etat		0.014	-1.006
Comprehensive search		0.174	-0.616
Interactive items			
Number of independent external directors× Crown heir			-0.014
Number of independent external directors× Horse race			0.045
Number of independent external directors× Coup d'etat			-0.235
Number of independent external directors× Comprehensive search			0.678
Manager ownership× Crown heir			0.091
Manager ownership× Horse race			-0.217
Manager ownership× Coup d'Etat			0.809
Manager ownership× Comprehensive search			-0.147
Larger shareholder ownership× Crown heir			-0.418
Larger shareholder ownership× Horse race			0.431
Larger shareholder ownership× Coup d'Etat			-1.213**
Larger shareholder ownership× Comprehensive search			0.752
Decision-making power of CEO× Crown heir			-0.320
Decision-making power of CEO× Horse race			-0.184
Decision-making power of CEO× Coup d'Etat			-0.129
Decision-making power of CEO× Comprehensive search			-0.205
F	8.718	4.892	3.620
Significance	0.000***	0.000***	0.000***
R^2	0.213	0.238	0.444
ΔR^2	0.213	0.025	0.206

Data source: Self-sorted in the study.

Conclusion. Having centered on corporate governance, the relationship between corporate governance, enterprise successor selection, and financial performance were found the following relations, including enterprise successor selection being able to affect corporate governance and financial performance, corporate governance showing positive effects on financial performance, enterprise successor selection presenting positive effects on corporate governance, and enterprise successor selection revealing positive effects on financial performance. Directors, supervisors, and managers in family-owned firms in Asian countries, including Taiwan, are often relatives and possess the decisive voting power with cross-shares. The asymmetric information results in opaque management and supervision for family-owned firms, and the equity of small shareholders are neglected that investors are likely to hang back. Such a situation could cause managerial difficulty in family-owned firms that the capital market cannot be active. Family-owned firms often employ relatives that excellent talents can hardly enter the decisive management level. Instead, incompetent family members occupy the important posts that the ownership and the operating concessions are confused. Although Chinese people remain traditional about sons taking over fathers' practice, it is not the only way for every family-owned firm. An active enterprise should change and innovate its organization with the development and the factors of time and space to cope with environmental changes. Family-owned firms should break through the restriction of not passing down to others and introduce talents beyond the family, when devoting to cultivating family successors, so that talents could come to the fore under a fairly competitive condition.

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