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Abstract

Purpose: The aim of the study was to assess the effect of corporate governance on financial performance in China.

Methodology: This study adopted a desk methodology. A desk study research design is commonly known as secondary data collection. This is basically collecting data from existing resources preferably because of its low cost advantage as compared to a field research. Our current study looked into already published studies and reports as the data was easily accessed through online journals and libraries.

Findings: The study indicated a positive correlation between strong corporate governance practices and improved financial outcomes for companies. These practices typically include transparent decision-making processes, effective board oversight, and alignment of management incentives with long-term shareholder value. Study suggests that companies with robust corporate governance structures tend to

experience higher profitability, better risk management, increased investor confidence, and enhanced access to capital. Additionally, strong corporate governance is associated with lower instances of financial misconduct and improved overall corporate reputation, which can further contribute to sustainable financial performance over time.

Implications to Theory, Practice and Policy: Agency theory, stewardship theory and resource dependency theory may be used to anchor future studies on assessing the effect of corporate governance on financial performance in China. Implement best practices in corporate governance that align with empirical findings and theoretical insights to optimize financial performance. Advocate for regulatory frameworks and policies that incentivize effective corporate governance practices and align them with desired financial performance outcomes.

Keywords: *Corporate Governance, Financial Performance*

INTRODUCTION

Corporate governance refers to the system of rules, practices, and processes by which companies are directed and controlled. It plays a crucial role in shaping the financial performance of companies. In developed economies like the USA, financial performance indicators such as profitability, return on assets (ROA), and stock market performance reflect the robustness of companies. For instance, according to a study by Smith, Brown & Davis (2018), the average profitability of companies in the USA increased by 15% over the past five years, driven by factors such as technological advancements, market expansion, and operational efficiencies. This upward trend in profitability signifies a healthy business environment and effective management strategies.

Similarly, in the UK, financial performance metrics have shown positive trends. Research by Johnson and Thompson (2019) revealed that return on assets (ROA) for companies in the UK increased by 10% in the last fiscal year, indicating improved asset utilization and profitability. Moreover, stock market performance, as measured by indices such as the FTSE 100, has demonstrated steady growth, reflecting investor confidence and economic stability. These examples underscore the resilience and competitiveness of companies in developed economies, translating into favorable financial performance metrics.

In developing economies such as Brazil, financial performance indicators have undergone notable shifts in recent years. Research by Silva and Oliveira (2019) highlighted that profitability in Brazilian companies has been influenced by economic policies, market volatility, and currency fluctuations. Despite facing challenges like inflation and political uncertainty, some sectors in Brazil, particularly technology and renewable energy, have shown significant growth in profitability, driven by innovation and government incentives. However, return on assets (ROA) for companies in Brazil has been relatively lower compared to developed economies, reflecting challenges in asset utilization and operational efficiency.

Similarly, in China, financial performance metrics have demonstrated a mixed picture. According to a study by Li and Zhang (2021), Chinese companies have experienced rapid growth in profitability, especially in the technology and e-commerce sectors. However, concerns around debt levels and regulatory changes have impacted stock market performance, leading to fluctuations in investor confidence. Return on assets (ROA) in China has varied across industries, with state-owned enterprises and tech giants often outperforming traditional sectors. Overall, China's financial performance reflects the complex interplay between economic policies, market dynamics, and global trade relations.

In India, another prominent developing economy, financial performance trends have shown resilience despite challenges. Research by Kumar and Singh (2020) indicated that Indian companies have navigated through economic fluctuations and regulatory changes to maintain steady profitability. Sectors such as information technology (IT), pharmaceuticals, and consumer goods have contributed significantly to India's overall financial performance, with high return on assets (ROA) and stock market performance. However, issues such as infrastructure gaps, bureaucratic hurdles, and market competition continue to impact the financial performance of certain industries.

In Indonesia, financial performance indicators have reflected the country's economic growth and diversification efforts. A study by Susanto and Prasetyo (2021) pointed out that Indonesian companies, particularly in the energy, infrastructure, and finance sectors, have shown improved

profitability and stock market performance. Return on assets (ROA) has also increased steadily, driven by infrastructure investments and government initiatives. Despite challenges related to regulatory reforms and global economic uncertainties, Indonesia's financial performance demonstrates opportunities for growth and investment.

Moving to the Middle East, the United Arab Emirates (UAE) has seen significant developments in its financial performance landscape. According to a study by Al-Muharfi and Al-Dhubai (2022), companies in the UAE have benefited from diversification efforts, particularly in sectors like tourism, real estate, and logistics. This diversification has contributed to improved profitability and return on assets (ROA), although fluctuations in oil prices and regional geopolitical tensions have posed challenges. The UAE's strategic location, business-friendly policies, and investment in infrastructure have supported its financial performance and attractiveness to investors.

In contrast, developing economies like India have experienced mixed financial performance outcomes. A study by Patel and Desai (2020) noted that while some sectors in India exhibited high profitability rates, others struggled due to regulatory challenges and market volatility. Return on assets (ROA) in developing economies can vary significantly across industries, with sectors such as technology and healthcare often outperforming traditional sectors like manufacturing and agriculture. Despite these challenges, the overall financial performance of companies in developing economies has shown gradual improvement, driven by economic reforms, globalization, and increased investment.

In South Africa, financial performance metrics have been influenced by factors such as commodity prices, exchange rates, and domestic policies. Research by Ndlovu and Dlamini (2020) highlighted that South African companies have faced challenges related to currency volatility and economic uncertainties. However, sectors like mining, telecommunications, and financial services have contributed to overall profitability and return on assets (ROA). Despite external challenges, South Africa's financial markets have shown resilience, attracting foreign investment and supporting stock market performance.

In Nigeria, another significant economy in Africa, financial performance indicators have shown mixed outcomes. According to a study by Adeoye and Adetayo (2019), Nigerian companies have experienced fluctuations in profitability due to factors such as regulatory changes, market competition, and infrastructure constraints. However, sectors like banking, telecommunications, and agriculture have demonstrated strong performance in terms of return on assets (ROA) and stock market valuation. Efforts to improve governance, infrastructure, and business environment have contributed to Nigeria's overall financial performance stability.

In Sub-Saharan African economies, financial performance indicators have been influenced by factors such as political stability, infrastructure development, and global market dynamics. For example, a study by Mbeki and Ngubane (2019) highlighted that countries like South Africa have seen fluctuations in profitability due to currency fluctuations and commodity price volatility. However, initiatives aimed at improving governance, promoting entrepreneurship, and enhancing access to finance have contributed to a more favorable financial performance outlook in Sub-Saharan Africa. Stock market performance in countries like Nigeria and Kenya has also shown resilience, attracting foreign investment and fostering capital market growth.

Corporate governance practices play a crucial role in shaping a company's financial performance. One significant practice is the composition of the board of directors, where having a diverse and

independent board positively impacts financial performance. Research by Smith (2019) suggests that boards with a mix of expertise, gender, and background bring diverse perspectives, leading to better decision-making and risk management, ultimately contributing to higher profitability and return on assets (ROA). Another vital aspect is executive compensation, where aligning compensation packages with company performance and long-term shareholder value positively influences financial outcomes. Study by Johnson (2020) have shown that companies with performance-based executive compensation structures tend to have better stock market performance, as executives are incentivized to make decisions that benefit shareholders.

Furthermore, shareholder rights, such as voting power and information transparency, significantly impact financial performance. Research by Brown (2018) indicates that companies with strong shareholder rights protection experience higher investor confidence, leading to increased stock market valuation and liquidity. Moreover, robust shareholder rights contribute to effective corporate oversight and accountability, enhancing trust and long-term investor engagement. Overall, these corporate governance practices, including board structure, executive compensation alignment, and shareholder rights protection, play a pivotal role in shaping a company's financial performance by fostering transparency, accountability, and strategic decision-making.

Problem Statement

Despite the recognized importance of corporate governance practices in influencing financial performance, there remains a need to empirically assess the specific mechanisms through which corporate governance impacts financial outcomes. Existing literature provides insights into the general relationship between corporate governance and financial performance; however, there is limited research that delves into the nuanced aspects of board structure, executive compensation, and shareholder rights and their direct influence on profitability, return on assets (ROA), and stock market performance within specific industries and regions (Smith, 2019; Johnson, 2020). Furthermore, the dynamic nature of business environments and regulatory frameworks necessitates ongoing investigation to understand how evolving governance practices, such as environmental, social, and governance (ESG) considerations, impact financial performance metrics in contemporary contexts (Brown, 2018). Therefore, this study aims to address these gaps by conducting a comprehensive analysis of the effect of corporate governance practices on financial performance, considering industry-specific variations and recent developments in corporate governance frameworks.

Theoretical Framework

Agency Theory

Originating from Jensen and Meckling in 1976, Agency Theory focuses on the relationship between principals (shareholders) and agents (management), emphasizing the potential conflicts of interest between them. The theory posits that managers may act in their self-interest, leading to agency costs and potential wealth expropriation from shareholders. In the context of corporate governance and financial performance, Agency Theory is relevant as it highlights the importance of governance mechanisms such as board independence, executive compensation alignment, and shareholder rights in mitigating agency problems and enhancing firm value (Chang, 2021).

Stewardship Theory

Developed as a counterpoint to Agency Theory, Stewardship Theory emphasizes trust, cooperation, and alignment of interests between managers and shareholders. Originating from Davis in 1997, this theory suggests that managers, acting as stewards, will prioritize the long-term interests of shareholders over self-interest, leading to improved financial performance. Stewardship Theory is relevant to the research topic as it provides insights into how governance practices that foster trust, transparency, and mutual goals can positively impact firm performance (Brown, 2020).

Resource Dependency Theory

Resource Dependency Theory, introduced by Pfeffer and Salancik in 1978, examines how organizations depend on external resources and relationships for survival and growth. In the context of corporate governance and financial performance, this theory highlights the importance of governance structures that facilitate access to critical resources, such as capital, knowledge, and strategic partnerships. Governance mechanisms that enhance resource acquisition and utilization can lead to improved financial outcomes and competitive advantage (Clarkson, 2019).

Empirical Review

Brown (2018) examined the impact of board diversity on financial performance within European firms. Utilizing panel data analysis spanning a rigorous five-year period and employing metrics such as gender, expertise, and nationality diversity, the study delved into the nuanced aspects of board compositions. The findings of the study revealed a compelling positive correlation between higher board diversity and improved financial metrics, specifically return on assets (ROA) and stock market performance. This correlation suggests that diverse board compositions, incorporating a range of perspectives and experiences, contribute significantly to enhanced decision-making, risk management, and ultimately, profitability. Moreover, the study advocates for the promotion of diverse board compositions as a strategic initiative to not only improve financial performance but also create substantial value for stakeholders and enhance corporate governance practices. The research, therefore, sheds valuable light on the intricate relationship between board diversity and financial outcomes, emphasizing the pivotal role of inclusive governance practices in modern organizations.

Johnson (2020) explored the relationship between executive compensation structures and firm profitability in the U.S. technology sector was meticulously analyzed. Through rigorous regression analysis and a thorough examination of executive pay alignment with company performance metrics across a sizable sample of 50 technology companies, the study uncovered significant insights. The findings revealed a clear association between performance-based executive compensation structures and heightened profitability, alongside increased returns in the stock market. These results underscore the critical importance of linking executive compensation to tangible performance metrics to effectively incentivize value creation and bolster overall financial performance within organizations. The study further recommends the adoption of performance-linked executive compensation plans as a strategic imperative, aimed at not only driving shareholder value but also optimizing firm performance comprehensively. Consequently, this research provides valuable insights into the intricate dynamics between executive compensation frameworks and their impact on financial outcomes and organizational success, particularly in the dynamic landscape of the technology sector.

Chang (2021) evaluated the impact of shareholder rights protection on financial performance across emerging markets. Employing a robust cross-sectional analysis encompassing 100 companies spanning diverse emerging economies and assessing the strength of shareholder rights through specialized indices, the study unearthed significant correlations. The findings elucidated a positive association between robust shareholder rights protection and enhanced financial outcomes, as evidenced by higher market valuation and improved liquidity metrics. These results underscore the pivotal role of robust governance frameworks in fostering sustainable financial growth and bolstering overall financial performance within organizations operating in emerging markets. Moreover, the study recommends strategic enhancements in legal frameworks and corporate governance practices to safeguard shareholder rights effectively. By doing so, organizations can not only protect investor interests but also foster market confidence and promote long-term financial success. Hence, this research offers invaluable insights into the intricate interplay between shareholder rights protection and financial performance dynamics, particularly within the context of emerging market economies.

White (2019) assessed the influence of audit committee effectiveness on firm profitability, with a specific focus on the banking sector. Through a comprehensive approach involving surveys, interviews with audit committee members from 20 banks, and an in-depth examination of committee composition, responsibilities, and practices, the study yielded profound insights. The findings revealed a compelling correlation between effective audit committees and superior financial performance metrics, such as return on equity (ROE) and net income margin. These results underscored the critical role of audit committees in enhancing financial performance and ensuring robust regulatory compliance within the banking sector. Additionally, the study recommended strategic enhancements in audit committee oversight and independence as viable strategies to bolster financial performance and ensure effective governance within banking institutions. Consequently, this research contributes significantly to understanding the nuanced dynamics of governance mechanisms, particularly within the context of the banking sector, and their impact on financial outcomes and regulatory adherence.

Zhang (2018) examined the impact of CEO duality on corporate financial performance, focusing specifically on Chinese state-owned enterprises (SOEs). Through a meticulous analysis of financial data from 50 SOEs and a comparative assessment of performance metrics between companies with separate CEO and board chair roles versus dually appointed CEOs, the study unveiled noteworthy findings. The results indicated a negative correlation between CEO duality and key financial metrics such as return on assets (ROA) and market valuation within SOEs. This negative correlation suggests potential governance challenges associated with concentrated power and decision-making roles. Consequently, the study advocates for encouraging the separation of CEO and board chair roles as a strategic imperative to improve governance effectiveness and enhance financial performance within SOEs. By promoting separation, organizations can mitigate governance risks and foster more robust governance structures conducive to sustained financial success. Therefore, this research provides valuable insights into governance structures within the context of state-owned enterprises and their impact on critical financial outcomes.

Green (2022) explored the intricate relationship between sustainability practices and financial performance within European manufacturing firms. Employing a longitudinal analysis encompassing sustainability disclosures and financial data from 100 manufacturing companies, the study unraveled compelling insights. The findings demonstrated a clear positive correlation

between robust sustainability practices and heightened financial performance metrics, such as profitability and market value. These results underscored the pivotal role of sustainability initiatives in driving competitive advantages and bolstering overall financial performance within the manufacturing sector. Moreover, the study recommended promoting sustainable business practices as a strategic imperative to optimize financial outcomes and enhance organizational success comprehensively. By encouraging sustainability, organizations can not only drive financial success but also foster environmental responsibility and social impact, thus contributing positively to long-term organizational sustainability. Consequently, this research contributes significantly to understanding the intricate interplay between sustainability initiatives and financial performance dynamics within specific industry contexts.

Oliveira (2021) examined the profound impact of governance reforms on financial performance within South American public companies. Through a methodical approach involving event study methodology, the study analyzed stock market reactions to governance policy announcements and subsequent changes within a sample of 50 public firms. The findings elucidated positive market reactions and improved financial performance indicators following governance reforms, underscoring the significance of enhanced governance practices in bolstering investor trust and financial success. Additionally, the study recommended continuous monitoring and implementation of governance reforms as viable strategies to ensure effective governance and sustained financial growth within public companies. By adopting a proactive approach to governance, organizations can foster market confidence and promote long-term financial success comprehensively. Therefore, this research provides valuable insights into the intricate dynamics of governance reforms and their profound influence on critical financial outcomes within the unique context of South American public companies.

METHODOLOGY

This study adopted a desk methodology. A desk study research design is commonly known as secondary data collection. This is basically collecting data from existing resources preferably because of its low cost advantage as compared to a field research. Our current study looked into already published studies and reports as the data was easily accessed through online journals and libraries.

RESULTS

Conceptual Gap: While the studies by Brown (2018) and Johnson (2020) extensively explore the impact of board diversity and executive compensation structures on financial performance, respectively, there is a conceptual gap in understanding the combined influence of these factors. Investigating how diverse board compositions, along with performance-based executive compensation, jointly contribute to financial outcomes could offer a more comprehensive understanding of governance dynamics. This could involve analyzing how diverse boards influence the design and effectiveness of executive compensation plans, thereby affecting financial performance measures such as ROA and stock market performance. Bridging this conceptual gap would provide deeper insights into the synergistic effects of board diversity and executive compensation on organizational financial success.

Contextual Gap: Chang (2021) study focused on emerging markets, highlighting the importance of shareholder rights protection in fostering financial performance. However, there is a contextual gap in understanding how governance practices vary across different market segments within

emerging economies. Research could delve into specific contextual factors, such as regulatory environments, cultural norms, and industry structures, to assess their impact on governance effectiveness and financial outcomes. For instance, comparing governance practices and financial performance between different sectors or regions within emerging markets could reveal nuanced insights into contextual variations. Addressing this contextual gap would enhance our understanding of how governance mechanisms operate within diverse market contexts and their implications for financial performance.

Geographical Gap: While the studies by Brown (2018), Johnson (2020), Chang (2021), White (2019), Zhang (2018), Green (2022), and Oliveira (2021) cover Europe, the US technology sector, emerging markets, banking sectors, Chinese SOEs, European manufacturing firms, and South American public companies, respectively, there is a geographical gap concerning other regions such as Africa or the Middle East. Exploring governance practices and their impact on financial performance in these regions could offer a more globally inclusive perspective. Analyzing how governance reforms, board structures, or executive compensation models differ in these regions and their effects on financial metrics would contribute to a broader understanding of corporate governance's geographical implications. Closing this geographical gap would enrich the literature by providing insights into governance practices and financial performance outcomes across diverse global regions.

CONCLUSION AND RECOMMENDATIONS

Conclusion

In conclusion, the effect of corporate governance on financial performance is a multifaceted and crucial aspect of organizational management. Through extensive empirical studies and research, it has been established that effective corporate governance practices significantly influence financial outcomes, including profitability, return on assets, and stock market performance. The studies reviewed highlight various dimensions of corporate governance, such as board diversity, executive compensation structures, shareholder rights protection, audit committee effectiveness, CEO duality, sustainability practices, and governance reforms, all of which play pivotal roles in shaping financial performance metrics.

The findings underscore the importance of inclusive governance practices, performance-based executive compensation, robust shareholder rights protection, effective audit committee oversight, separation of CEO and board chair roles, sustainable business practices, and continuous governance reforms in driving positive financial outcomes. These governance mechanisms not only contribute to enhanced decision-making, risk management, and regulatory compliance but also foster investor trust, market confidence, and long-term organizational sustainability. Moreover, the studies emphasize the need for tailored governance frameworks that align with specific industry contexts, regulatory environments, and geographical regions to optimize financial performance comprehensively.

Overall, the research reviewed provides valuable insights into the intricate dynamics between corporate governance practices and financial performance, highlighting the critical role of governance mechanisms in creating value for stakeholders, enhancing organizational success, and promoting sustainable growth. The continuous exploration and implementation of effective governance practices are essential for organizations to navigate complex business environments, mitigate risks, seize opportunities, and achieve enduring financial success.

Recommendations

The following are the recommendations based on theory, practice and policy:

Theory

Conduct further research to explore the nuanced interactions between different dimensions of corporate governance, such as board diversity, executive compensation structures, and shareholder rights protection, in influencing specific financial performance metrics. This could involve developing comprehensive theoretical frameworks that integrate various governance mechanisms and their collective impact on profitability, return on assets, and stock market performance. Theoretical advancements in understanding the synergistic effects of governance practices on financial outcomes would contribute significantly to the corporate governance literature.

Practice

Implement best practices in corporate governance that align with empirical findings and theoretical insights to optimize financial performance. This includes promoting diverse board compositions, adopting performance-based executive compensation plans, enhancing shareholder rights protection mechanisms, strengthening audit committee effectiveness, encouraging separation of CEO and board chair roles, embracing sustainable business practices, and embracing continuous governance reforms. Organizations should tailor their governance structures to suit their industry context, regulatory requirements, and stakeholder expectations to achieve sustainable financial success.

Policy

Advocate for regulatory frameworks and policies that incentivize effective corporate governance practices and align them with desired financial performance outcomes. Policy interventions could include guidelines on board diversity quotas, transparency in executive compensation disclosures, enforcement of shareholder rights, standards for audit committee oversight, mandates for separating CEO and board chair roles, incentives for adopting sustainable business practices, and support for governance reform initiatives. Collaborative efforts between governments, regulatory bodies, industry associations, and academia are essential to create conducive policy environments that promote sound governance and drive positive financial performance across sectors.

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