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**The Impact of Corporate governance on Corporate Performance ——Evidence
from China**

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Abstract

The goal of this research was to test the influence of corporate governance on the performance of listed companies on the Chinese stock exchange. The study methodology is based on a collection of data from the CSMAR from 2009 to 2018. A total of 2107 publicly traded companies are included in the analysis. Corporate Governance principles, such as board size, board independence, and shareholder activism, constitute the study's independent variable. The dependent variables for measuring corporate performance were ROA, EPS, and Tobin's Q. The research will cover two control variables to measure and evaluate the link between corporate governance on the performance. Multiple links between corporate governance and company performance have been discovered in this empirical investigation. First, the size of the board of executives has a favorable correlation with corporate performance in terms of ROA and EPS. Second, in terms of EPS and Tobin's Q, board independence is positively related to corporate performance. Third, according to EPS and Tobin's Q, shareholder activism has a positive link with the corporate performance. Moreover, advice for managers of these results also showed in this paper. All in all, corporate governance policies have an influence on a company's success, and the better the company's governmental structure is, the better the company performs.

Keywords: Corporate performance, Corporate governance, Board size, Board independence, Shareholder activism, China

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Introduction

The connection between corporate governance and corporate performance in China is experimentally tested in this research. There are different forms and definitions of corporate governance. Corporate governance, for instance, is defined as "the system by which companies are planned and managed" by Shleifer, Andrei, and Robert (1997). According to the Organization for Economic Co-operation and Development, "Corporate governance refers to the private and governmental institutions, including laws, rules, and recognized business practices, that jointly govern the relationship, in a market economy, between corporate management and entrepreneurs," as an OECD definition released in 2001.

In China, Corporate governance has come up and developed as China has shifted from a planned economy to a market economy. The development and growth of China's capital market, as well as the evolution of Chinese enterprises from government-owned enterprises to modern corporations, have necessitated the creation of a new corporate governance structure (OECD, 2011). According to Bai& Chong-En et al. (2004), the governance structure of Chinese listed companies is of poor quality due to unrestricted managerial discretion, a low level of outsider safe conduct, and inadequate transparency difficulties.

Effective corporate governance helps to foster an atmosphere of trust, openness, and accountability, which is critical for solid investment, economic stability, and business integrity, leading in faster growth and so more inclusive societies. Bai& Chong-En etl (2004) discovered that well-established corporate governance structures

are associated with better stock market value in a study of Chinese companies. They mentioned that unrestricted managerial discretion, a lower level of outsider safe conduct, and unacceptable transparency difficulties, the governance structure of Chinese public companies is of very low quality. For example, despite the fantastic improvements in the Chinese state-owned enterprise (SOE) governing body, there is still a large void to fill.

Recently, due to an increase in the number of bankruptcies caused by fraud or financial accounting errors, the focus on corporate governance has shifted. The reason for these cases was the lack of corporate governance regulations in the organizations, which resulted in the implementation of different accounting practices, increased personal interest, and biased reporting (Ioana, 2014). Thus, the importance of corporate governance raised people's attention. In European societies, there has been a great deal of research on the implications of corporate governance on company performance. In China, however, there are little research on corporate governance.

Literature review

The purpose of this literature review is to seek the answer for the relationship between corporate governance with the corporate performance. This literature review will discuss ten research articles and focus mainly including the measurement of corporate performance, board size, board independence, shareholder activism with the corporate performance of these viewpoints will be discussed as below:

1. Corporate performance measurement

Earnings Per Share (EPS), Return on Assets (ROA), and Return on Investment (ROI) are the most frequent measures to measure company success (ROI). Shi (2013) uses a multiple linear regression model to examine the relationship between stock options and listed company performance, utilizing management shareholding ratio, stock price, and asset-liability ratio as financial indexes and firm development potential as a non-financial index. By integrating the effectiveness of Data envelope analysis with financial indicators, Li & Ma (2005) argue that Data envelope analysis is effective as a tool to measure input-output performance. Furthermore, data envelope analysis study can accurately anticipate a company's financial performance. The following techniques of measuring firm success, according to Qitong (2018), are more plentiful than the utilization of EPS, ROA, and ROI alone. Apart from that, Chung and Pruitt mentioned the importance of Tobin's Q as a measurement of corporate performance. The Tobin q could be employed to describe a range of aspects, such as (a) cross-sectional distinctions in investment and diversification choices, (b) the relationship between management equity and value of the firm, (c) the

relationship between performance management and tender offer gains, investment options, and tender offer responses, and (d) financing, dividend, and compensating policies (Chung and Pruitt, 1994). The impact of board size on corporate performance

The empirical investigations indicated that there is a mixed association between board size and business performance. According to Guest (2009), the size of the board of directors has a negative relationship with company success as assessed by ROA. However, other articles show the adverse results. Several studies have identified a positive link between board size and firm success: larger board sizes can enhance the corporate performance more effectively (Adhikary & Huynh & Hoang, 2014; Fauzi & Locke, 2012; Jackling & Johl, 2009;). This positivity can be explained in a variety of ways. One of the arguments in favor of larger boards is resource dependency.

Directors on larger boards come from a wide range of backgrounds and possess a diverse set of skills. The experience and brains of these employees can be put to good use in the business to help with decision-making and strategy planning. Apart from that, Bennedsen, Kongsted, and Nielson (2008) illustrated an important argument is that there is an optimal board size beyond which performance of the company is impaired. The result from different countries and difference methodologies differs a lot. According to Guest (2009), the influence of board size on company performance differs based on the country's industry structure and the board's specific goal, so the relationship between board size and company performance is really not properly delineated from these perspectives. The board structure plays a varied role in corporate governance, resulting in improved financial performance of enterprises and,

as a result, higher investor wealth (Jackling & Johl, 2009). Firms in emerging economies, on the other hand, have fewer financial incentives to perform better due to the weak governance framework (Fama & Eugene & Michael & Jensen, 1985). They claimed that increasing board size beyond a certain point is harmful to the company and could result in poor performance.

H1: The size of the board of directors has a favorable correlation with company performance.

2. The impact of board independence on corporate performance

According to the Shanghai Stock Exchange (2004), 70 percent of the total of independent directors are nominated by the firm's top shareholders. Board independence lowers insider self-dealing, promotes investment efficiency, and enhances business performance in government-controlled firms. The results back up the concepts that independent directors are effective in monitoring and that the government should appoint stronger boards to minimize insider self-dealing and credibly express a commitment not to engage in corporate operations. In addition, Wang (2014) summarizes the findings of 30 empirical studies in China that looked at the link between board independence and firm success. Five publications report a considerably positive link, four publications report a considerably negative link, while the remaining twenty-one papers report an insignificant relationship, according to Wang (2014). The present state of the literature is summarized by Wang (2014, page 5): "In China, empirical research on the relationship between independent directors and company performance appears to be numerous in scope but not in depth."

Furthermore, Yu et al, (2014) find that independent directors have an overall positive impact on the operating performance of China's listed firms. They investigate two key channels through which independent directors can impact firm performance in China, by constraining insider “self-dealing” and by improving investment efficiency, respectively.

H2: Corporate performance and board independence have a beneficial association.

3. The performance effect of the shareholder activism

Shareholder activism is considered as a potential means of enhancing performance through institutional investors' active participation in corporate governance. In terms of the impact of institutional investors participating in corporate governance, there are two contradictory findings. Some believe that institutional investors' involvement in corporate governance has a significant influence on performance. According to Chidambaran and John (1998), if institutional investors own a large percentage of a company's stock, they can more easily identify operational and managerial issues, and thus can make proactive proposals and put pressure on management to solve these issues and protect shareholders' interests. An opposite viewpoint is that institutional shareholders have a negative impact on corporate governance. Nelson and Peterson examine the company's performance on the CII selected firms list using empirical study (Nelson and Peterson, 2004). The findings reveal that while institutional investors' active participation has modified the corporate governance structure, the impact on enhancing company performance is

minor, if not negative. Nevertheless, Victor and Maria (2021) show that shareholder activism does have an impact on business profitability after activist campaigns, but not in the way we predicted. They discovered that corporations' profits drop quickly after an activist campaign. When one considers the restructuring effect that is frequent in such campaigns, this outcome may not come as a surprise. The findings imply that profitability declines in the short term, but that this effect fades away in subsequent years.

H3: Shareholder activism correlates positively with company performance.



Methodology

This research is aiming to study how board size, board independence and institutional investors actively participating in corporate governance impacts on corporate performance, to do so the research works to explore the effects of corporate governance on different types of performance including financial, operational and market performance. In the opinion of Roudaki and Bhuiyan, company performance can be evaluated by three indicators: ROE, ROA, and Tobin's Q. Moreover, EPS is also the common measurement for corporate performance. Therefore, this study used EPS, ROA, Tobin's Q as the measurement for listed companies' corporate performance.

Table 1 shows the definitions and measurements for all variables.

Table 1 Description and measurement of variables

Variables	Description	Measurement
Dependent Variables		
ROA	Return on asset	Taking net revenue and dividing it by the average total assets
EPS	Earning per share	Profit divided by the outstanding shares of common stock
Tobin's Q	Q ratio	Market value divided by asset replacement cost
Independent Variables		
Board size	Size of the board	Total number of board directors
Board independence		Percentage of share\ Percentage of independent members over total
Shareholder activism		The initiative of institutional Institutional investors' shareholding ratio shareholders to participate
Control Variables		
Firm age	Age of the firm	The number of years since firm creation
Firm size	Size of the firm	Total assets of the company

This research employs a range of corporate governance metrics as well as three corporate performance metrics, which are described in detail here below: (1)

$$ROA_{it} = \alpha_0 + \beta_1 BOARD_SIZE_{it} + \beta_2 BOARD_INDEPENDENCE_{it} + \beta_3 SHAREHOLDER_ACTIVISM_{it} + \beta_4 FIRM_AGE_{it} + \beta_5 FIRM_SIZE_{it} + \epsilon_{it}$$

$$(2) \quad EPS_{it} = \alpha_0 + \beta_1 BOARD_SIZE_{it} + \beta_2 BOARD_INDEPENDENCE_{it} + \beta_3 SHAREHOLDER_ACTIVISM_{it} + \beta_4 FIRM_AGE_{it} + \beta_5 FIRM_SIZE_{it} + \epsilon_{it}$$

$$(3) \quad Tobin_{it} = \alpha_0 + \beta_1 BOARD_SIZE_{it} + \beta_2 BOARD_INDEPENDENCE_{it} + \beta_3 SHAREHOLDER_ACTIVISM_{it} + \beta_4 FIRM_AGE_{it} + \beta_5 FIRM_SIZE_{it} + \epsilon_{it}$$

Where α_0 is represented for the intercept, β_i ($i=1, 2, 3, 4, 5$) is the coefficient of regression model, ϵ_{it} is the random error term.

This article selects the listed companies from 2009 to 2019 as the research objects. The data mainly comes from the CSMAR database and is limited in fuel & energy, manufacturing, and service industries. After completing the corresponding indicators, the data is processed as follows: (1) Excluding the financial industry and companies with missing data; (2) Exclude companies with ST and *ST during the sample period; ST (Special Treatment) companies (listed companies with abnormal financial status or other abnormalities) have more influencing factors in stock prices. Corporations with financial troubles or other anomalies must be excluded to effectively examine the impact of corporate governance on corporate performance. In order to avoid the influence of outliers, the article performs Winsor processing at the first and last ends of all continuous variables at the 1% level. Through the above

screening, there are 2107 companies finally collected, which are unbalanced panel data, and the total sample is 11932.

Preliminary results and discussion

Variables of the research including three independent variables, three dependent variables and two control variables. Independent variables are consisted of board size, board independence and shareholder activism. ROA, EPS, and Tobin's Q are examples of dependent variables. Firm ages and firm size are control variables. As larger firms tend to perform better, controlling firm size (the value of total assets) is crucial, because of the effects of scale.

Table 2 shows the information about all variables mean, standard deviation, minimum and maximum data. Table 1 is a statistical technique that is descriptive research. In order to ensure the balance of data and prevent abnormal values from affecting the accuracy of subsequent calculations, the company size is logarithmized here, and all data is reduced by 1%. Through the overall descriptive analysis of the data, it is found that the mean value of ROA is 0.044, the maximum value is 0.205, the minimum value is -0.29, and its standard deviation is 0.064, indicating that the difference of each company's ROA is not obvious. As for the EPS and Tobin's Q, the mean values are 1.014 and 2.865, and the standard deviations are 1.463 and 2.372. This indicate that the differences between companies are slightly larger in these two indicators. In the aspect of shareholder activism, its average value is 0.339, indicating that the overall proportion of institutional investors in the sample data is relatively large. Combined with the status quo of listed companies in China, in addition to financing in the stock market during the development of a company, funds from external institutions have also become an important part of the source of corporate

funds, resulting in a large proportion of institutional investors in the capital market. For firm age, the minimum value is 3 years, indicating that the shortest time for establishment of the companies in the sample is 3 years, however, its average value is 14.732, indicating that most of the companies have been established for a long time and can develop steadily in the market. This is a follow-up analysis, and the financial indicators of these companies provide the basis for the foundation.

Table 2 Descriptive Statistics

Variable	Obs	Mean	Std.Dev.	Min	Max
ROA	11932	0.044	0.064	-0.29	0.205
EPS	11932	1.014	1.463	-1.623	7.892
Tobin's Q	11932	2.865	2.372	0.362	14.22
Board size	11932	8.241	1.414	5	12
Board independence	11932	0.376	0.052	0.333	0.571
Shareholder activism	11932	0.339	0.245	0.001	0.857
Firm age	11932	14.732	5.577	3	29
Firm size	11932	21.548	0.992	19.322	24.366

Table 3 shows the correlation analysis between variables. From the data in the table, we can see that the coefficients of ROA with board size, board independence and shareholder activism are 0.047, -0.025 and 0.095, which are all significant at the 1% level. A significant positive correlation has been found between board size and shareholder activism, and a negative relation exists between board independence and board size. Similarly, the correlation coefficients of EPS with board size and shareholder activism are 0.018 and 0.077, respectively, which are significant at the levels of 10% and 1%. Correspondingly, the correlation coefficients between Tobin's

Q with board size, board independence and shareholder activism are all significant at the 1% level, indicating that Tobin's Q also has a significant correlation with these dependent variables. This has played a supporting role for the follow-up research on the influence of independent variables on variables, but the correlation between variables can only indicate the mutual relationship between the two variables. To further analyze and study the influence between variables, the follow-up regression analysis will be used for further verification.

Table 3: correlation matrix among all variables

	ROA	EPS	Tobin's Q	Board size	Board independence	Shareholder activism	Firm age	Firm size
ROA	1							
EPS	0.546***	1						
Tobin's Q	0.174***	0.171***	1					
Board size	0.047***	0.018*	-0.099***	1				
Board independence	-0.025***	0.003	0.065***	-0.628***	1			
Shareholder activism	0.095***	0.077***	-0.035***	0.113***	-0.095***	1		
Firm age	-0.104***	-0.158***	-0.0150	-0.0120	0.0110	0.053***	1	
Firm size	0.021**	-0.019**	-0.472***	0.142***	-0.059***	0.259***	0.158***	1

*** p<0.01, ** p<0.05, * p<0.1

The linear regression analysis is presented in Table 4. In the case of controlling the year and industry, the regression analysis is performed with ROA, EPS, and Tobin's Q as dependent variables. In the first column, the regression analysis is

performed with ROA as the dependent variable. In this model, R² is 0.069, indicating that the explanatory variable has reached 6.9% of the explained variable. Among the various coefficients, the coefficients of board size and shareholder activism are 0.0013 and 0.0211, which are significant at the levels of 5% and 1%, indicating that both board size and shareholder activism can significantly promote ROA, but the coefficient of board independence is 0.0135, which is not significant, that is, board independence cannot significantly affect ROA. In the regression analysis with EPS as the dependent variable, R² is 0.083 in this model, indicating that the explanatory variable has reached 8.3% of the explained variable. Among them, the coefficients of board size, board independence, and shareholder activism are 0.0226, 0.9067, 0.4907, which are significant at the levels of 10% and 1%. We can see these three variables can significantly promote EPS. In the regression analysis with Tobin's Q as the dependent variable, R² is 0.473 in this model, indicating that the explanatory variable has reached 47.3% of the explained variable. The regression analysis shows that only the coefficients of board independence and shareholder activism are significant, and both are positive by observing the coefficients of the independent variables, which means board independence and shareholder activism can significantly improve Tobin's Q.

Table 4: Regression analysis

	(1)	(2)	(3)
VARIABLES	ROA	EPS	Tobin's Q
Board size	0.0013**	0.0226*	0.0200
	(2.49)	(1.87)	(1.34)
Board independence	0.0135	0.9067***	1.5343***
	(0.96)	(2.83)	(3.90)
Shareholder activism	0.0211***	0.4907***	1.1168***
	(8.45)	(8.68)	(16.07)
Firm age	-0.0012***	-0.0405***	0.0051
	(-10.27)	(-15.47)	(1.59)
Firm size	0.0020***	-0.0245	-1.2695***
	(3.08)	(-1.64)	(-69.33)
Industry/year	Control	Control	Control
Observations	11,932	11,932	11,932
R-squared	0.069	0.083	0.473
Adj R-squared	0.0637	0.0783	0.4702

t-statistics in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Conclusions

In conclusion, this paper constructs the panel data of the institutional shareholding ratio in 2107 listed companies from 2009 to 2018 on the Shanghai A-Share market and Shenzhen A-Share market as all the collected data is before COVID-19 so the conclusions would not be affected by the epidemic. The relationship between corporate governance and company performance is investigated based on a multiple panel regression model.

Specifically, the following conclusions can be drawn from the studies:

- Board Size is significantly positively correlated with EPS and ROA, which is consistent with the hypotheses presented in this paper that board size has a positive effect on company performance. It means that the larger board size, the better corporate performance.
- Board independence is significantly positively correlated with EPS and Tobin's Q, which is consistent with the hypotheses on board independence. Board independence can enhance the financial performance of a corporation.
- Shareholder Activism is significantly positively correlated with all EPS, ROA and Tobin's Q at 1% level, indicating that the higher the institutional shareholding ratio, the better the corporate performance. When the amount of shares held by institutional investors grows, it becomes easier for them to participate more actively in corporate governance, which improves corporate performance to some extent.

The empirical analysis results of ROA, EPS and Tobin's Q are similar, indicating a significant considerably positive association between board size, board independence, and shareholder activism with corporate performance, according to the regression analyses. These empirical studies all contribute to a better understanding of the impact of board size, board independence, and shareholder activism on the performance of China's listed corporations.

Implication

This document can provide Chinese enterprises with advice on how to strengthen governmental structures to increase their performance even further. The following suggestions are made:

- Expanding the Number of Board Sizes: In the Chinese setting, a larger board has a strong tie to the local or state government. In the long run, these can be useful to the company in terms of receiving financial and moral incentives from the government during times of difficulty or distress.
- Appointing more independent directors: The fact that many listed companies in China were previously state-owned enterprises (SOEs) and that the government is still the largest shareholder in many of these companies is a distinguishing feature of the Chinese corporate landscape. Therefore, this paper suggests that assigning independent directors who can effectively monitor firm management and uphold the goal of maximization of shareholder wealth can at least partially alleviate some

of the inherent inefficiencies associated with having the government as a dominant shareholder. Inside this setting of limited shareholder protection, the idea that board independence is an effective measure for solving agency problem adds validity to the idea that internal and external corporate governance mechanisms can be replaced for others.

- **Increasing Institutional Shareholding Ratio:** China has unique form of capitalism and system of corporate governance. According to Lin & Puchniak (2021) On a daily basis, the Chinese Communist Party (CCP) does not micromanage institutional investors. Rather, institutional investors follow free-market principles and are increasingly playing a key role in corporate governance. The proportion of institutional investors' shareholdings reflects the importance of institutional investors in the governance mechanism of listed businesses and their influence on managers. Even though the implementation of the split-share structure reform has given institutional investors the opportunity to grow their shareholdings in a variety of ways, the institutional shareholding ratio remains low as Table 2 shows. State-owned holding firms make up most shareholders. As a result, state-owned stocks should be lowered, while institutional investors' shareholding restrictions should be eased. Institutional investors will be more likely to actively participate in corporate governance in this way because it will benefit their own interests.

Limitation

Despite the accomplishments made in this paper, there are several limitations, such as (1) the only control variables are firm ages and size. (2) Other proxies of corporate performance include ROS, which is a ratio of net sales to total assets (Roudaki and Bhuiyan, 2015). (3) In order to guarantee that the data was balanced, several samples with insufficient disclosure of information between 2009 and 2018 were deleted, which may have influenced the accuracy of the data given. (4) The study period is insufficiently long, resulting in an inadequate reference value.

Future Study Direction

The study could be expanded in the future to include other governance variables such as CEO duality, board gender, the type of demands from shareholder activism, among others. The empirical literature on corporate governance context is limited in fuel& energy, manufacturing, and service industries, which could provide opportunities for researchers to dig deeper into these issues and produce some interesting results in this area of corporate governance. Furthermore, future studies covering large sample size over a prolonged period can be conducted. Future research can investigate the reason why board size is only statistically significant in Chinese enterprises when it comes to EPS and ROA, or the reason why board independence is only statistically significant when it comes to EPS and Tobin's Q.

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