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Challenging the norm: Organizational oversight and firm value in China's growth paradox

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Abstract
The classical theories of corporate governance, largely developed in the context of early industrialized economies, posit that robust governance mechanisms are essential for enhancing firm performance and shareholder value. Governance frameworks are critical for maintaining transparency, investor confidence, and ethical conduct in business operations. However, excessive regulatory compliance can sometimes constrain managerial flexibility and strategic decision-making, leading to inefficiencies. The remarkable economic growth of developing nations—particularly China—despite variations in governance models challenges the traditional one-size-fits-all approach to corporate governance. This study explores the paradoxical relationship between corporate governance and enterprise value by analyzing a panel dataset of 151 Chinese firms over a 12-year period. Employing the ESG governance pillar score as a comprehensive measure of corporate governance quality, the study finds that even moderate levels of governance compliance are significantly and positively associated with enterprise value. These findings suggest that while governance practices are crucial for ensuring accountability and stability, a balanced approach that does not stifle managerial autonomy may yield better firm performance. The results contribute to the growing discourse on contextual corporate governance in emerging markets, emphasizing the need for adaptive governance frameworks that align with local economic and institutional realities.

Keywords: Corporate governance, enterprise value, ESG governance score, china, capital structure, firm valuation, financial leverage, payout policy, developing countries

Introduction

The evolution of corporate governance systems can be traced back to the industrial revolutions in the West, particularly in countries like the United States and the United Kingdom. These early models emphasized shareholder primacy, transparency, board independence, and market-based oversight, establishing a framework that was later exported to other parts of the world. However, as governance frameworks found their way into the institutional fabric of developing economies, it became increasingly apparent that the original models did not align seamlessly with the structural and cultural dynamics of these new environments. In particular, the nature of business entities in many Asian and developing countries differs substantially from those originally envisioned in early industrialized economies. These differences are reflected not only in ownership structures—often characterized by concentrated family or state ownership—but also in the legal, regulatory, and cultural environments that govern business operations. Consequently, corporate governance systems have evolved to become highly country-specific, giving rise to diverse models and provisions across jurisdictions. Nowhere is this divergence more evident than in China. Despite the country's distinct political and economic systems, China has witnessed unprecedented economic growth and business expansion over the past two decades. Firms operating under governance frameworks that deviate from conventional Western norms have consistently delivered high levels of performance and enterprise value. This paradox—where governance practices that appear to be less rigorous still correlate with robust firm outcomes—calls into question the universality of classical corporate governance theories. Governance mechanisms serve a fundamental role in ensuring transparency, ethical business conduct, and investor confidence. A well-governed business environment promotes financial stability, mitigates risks, and enhances the credibility of firms in the eyes of

stakeholders. However, strict and inflexible adherence to governance norms may also introduce bureaucratic inefficiencies, hinder managerial autonomy, and reduce firms' ability to respond swiftly to dynamic market conditions. The balance between governance compliance and decision-making freedom is therefore a critical determinant of enterprise value. A rigid regulatory framework can lead to over-compliance, which may burden firms with unnecessary procedural constraints. Conversely, moderate and strategic governance practices can create an optimal environment where businesses operate ethically and transparently without stifling entrepreneurial innovation and managerial discretion. To explore this paradox, this study adopts a comprehensive and integrated approach to measuring corporate governance by using the governance pillar score from ESG datasets. Unlike many earlier studies that focus narrowly on individual components of corporate governance—such as board independence, ownership concentration, or audit quality—this paper treats corporate governance as a multifaceted and holistic phenomenon. The governance pillar score reflects a broader framework encompassing management structure, shareholder rights, transparency, audit mechanisms, and ethical practices. This enables a more complete and nuanced analysis of how governance in its entirety affects firm value. By adopting this broader perspective, the study addresses a significant gap in the literature and provides a more realistic representation of how governance mechanisms operate within complex organizational and institutional contexts.

This paper investigates the relationship between corporate governance and enterprise value in the context of Chinese firms. Using a sample of 151 publicly listed companies from the CSI 300 index over a 12-year period (2011-2022), the study finds a significant and positive impact of governance quality on enterprise value, even at moderate levels of compliance. This outcome suggests that tailored, context-specific governance mechanisms may offer better alignment with firm needs and institutional realities in emerging economies. By highlighting the empirical relationship between governance quality and firm value in China, this paper contributes to the growing body of literature that seeks to rethink and recontextualize corporate governance theories in a globalized economy. It offers new insights into how developing countries can leverage governance practices that are not only efficient but also compatible with their unique economic and institutional configurations. More importantly, it underscores the importance of striking a balance between regulatory oversight and managerial flexibility, ensuring that governance practices enhance rather than hinder firm performance.

Literature Review

Corporate governance has long been recognized as a critical determinant of firm performance and enterprise value. Seminal contributions by Shleifer and Vishny (1997) [21] and La Porta, Lopez-de-Silanes, Shleifer, and Vishny (1998) [16] laid the foundation for understanding how governance mechanisms mitigate agency problems, safeguard investor interests, and enhance firm value. The classical view emphasizes the role of independent boards, disclosure practices, shareholder rights, and audit mechanisms in fostering transparency and accountability in corporate behavior. Over the years, empirical studies have reinforced the theoretical link between governance quality and firm performance. Gompers, Ishii, and Metrick (2003) [10], using a governance index for U.S. firms, found a strong positive correlation between firm value and governance quality. Similarly, Bebchuk, Cohen, and Ferrell (2009) [4] demonstrated that firms with fewer governance constraints yielded superior stock returns and profitability, establishing governance as a central element of strategic corporate performance. However, much of the literature has centered on governance frameworks developed in early industrialized countries, particularly the Anglo-American model. This model is typically characterized by dispersed ownership, strong legal protection of investors, and a reliance on market-based oversight. As such, the empirical validity of these models in the context of developing and emerging market economies remains a subject of ongoing debate, Aguilera and Jackson (2003) [1] and Filatotchev *et al*. (2013) [8]. In the context of emerging economies, particularly in Asia, the structure and function of governance mechanisms often differ markedly. Claessens and Yurtoglu (2013) [7] observe that emerging markets are typically characterized by concentrated ownership, family-controlled businesses, and institutional voids that limit the effectiveness of Western-style governance mechanisms. This makes the transplantation of classical models less effective or even counterproductive in such environments. China, as a unique institutional setting, has attracted significant scholarly attention. Research on Chinese firms shows mixed results regarding the impact of governance on firm performance. Bai, Liu, Lu, Song, and Zhang (2004) [2] provided early evidence linking governance reforms in Chinese listed firms to enhanced performance and investor confidence. However, more recent studies suggest that the relationship is not linear. Liu, Uchida, and Yang (2012) [19] found that while governance reforms improved firm value, the effect varied across firm ownership types, with state-owned enterprises responding differently than private firms.

An important limitation in the existing literature is the fragmented approach to measuring corporate governance. Many studies focus narrowly on individual governance attributes such as board independence, CEO duality, or audit committee presence (e.g., Brick & Chidambaran, 2010; Larcker, Richardson, & Tuna, 2007) [5, 17], without capturing the full complexity of the governance framework. This piecemeal treatment overlooks the interactive and systemic nature of governance practices. In response to this limitation, more recent studies have adopted composite or holistic indices. For example, García-Sánchez *et al*. (2020) [9] utilized ESG scores to assess corporate sustainability and governance impacts, finding that governance quality positively correlates with financial performance across sectors. However, even within ESG-focused research, most studies originate from Western contexts, and applications to developing economies—especially China—remain limited and underexplored. Moreover, a recurring assumption in the literature is that stronger governance, in line with international best practices, universally enhances firm performance. Yet, some scholars have begun to challenge this premise. Yoshikawa and Rasheed (2009) argue that strict compliance with global governance norms may restrict managerial autonomy and be ill-suited to firms in dynamic, institutionally distinct environments. Similarly, Chen, *et al*. (2006) found that certain governance practices beneficial in one context could be neutral or even detrimental in others, depending on institutional conditions.

Thus, despite the extensive body of work on corporate governance and firm performance, several critical research gaps remain:

1. The bulk of governance-performance literature is based on developed countries, with insufficient attention to institutionally distinct economies like China, where governance structures are shaped by state influence, political considerations, and evolving market mechanisms.
2. Many studies employ reductionist governance proxies, failing to reflect the multifaceted nature of governance systems. This limits the explanatory power of the findings.
3. Prevailing theories often equate higher governance strictness with better outcomes, ignoring the possibility that moderate or context-specific governance levels may be more effective in certain settings.
4. Although ESG governance scores offer a comprehensive and integrated view of governance practices, their application in emerging market governance research remains sparse.

This study seeks to address these gaps by employing the governance pillar score from ESG data providers as a holistic measure of corporate governance, capturing its ethical, structural, and procedural dimensions. By focusing on a large panel of Chinese firms over 12 years, the paper offers empirical evidence on how governance frameworks—when adapted to local realities—can drive enterprise value even without full compliance with conventional governance norms. The findings highlight the strategic benefits of balanced governance, where transparency and investor confidence are maintained without unduly restricting decision-making autonomy.

Extensive literature in developed economies supports a positive association between corporate governance and firm value, as shown by Shleifer and Vishny (1997) [21] and Gompers *et al.* (2003) [10]. However, the findings from emerging markets like China present a more complex picture. Chinese firms have achieved high levels of performance despite relatively weaker formal governance mechanisms, challenging traditional governance-performance assumptions, as noted by Liu *et al.* (2012) [19] and Filatotchev *et al.* (2013) [8]. Previous studies often assess isolated governance variables, offering a narrow view. This study departs from that approach by using the governance pillar score as a comprehensive and holistic measure of a firm's governance framework. This allows for a fuller understanding of how governance, even at moderate levels, can influence firm value without overly constraining managerial discretion. In light of this, the study tests the following null hypothesis:

H_0: There is no significant impact of corporate governance practices—measured using the governance pillar score—on the enterprise value of Chinese firms.

Research Methodology

The relationship between these variables must be established over an extended period of time in order to test the impact of corporate governance on the value of the firm. The results of this experiment should be consistent and true for a sufficient number of entities. This requires taking advantage of a panel data set in the course of the study. Panel data is also referred to as longitudinal data or cross-sectional time series data due to its two-dimensional nature. A panel data set captures the dynamics of the relationship under study by capturing variations across cross-sectional entities over time. Consequently, it provides valuable and deeper insights into the relationship being studied.

Variable Description

Dependent Variable

Enterprise Value: The enterprise value of a corporation at year-end serves as the dependent variable in the study. Enterprise value quantifies the financial worth of a corporation. It is a more exhaustive metric than total market capitalisation, as it considers the complete capital structure of a company. The worth of a firm is the aggregate of the market value of its equity and the market value of its debt. Market capitalisation, representing the overall market worth of a corporation, solely reflects the value of stock shares, whereas enterprise value encompasses both equity and debt valuations. It enables the comparison of companies across various sectors and businesses and is frequently utilized by investors to assess a firm's value.

Independent Variable

Corporate Governance: The study employs the Corporate Governance Pillar Score, a component of the comprehensive Environmental Social and Governance (ESG) score, to assess the overall level of corporate governance in the organisations. The corporate governance pillar score evaluates a company's internal procedures and processes established to ensure that the board of directors and management act in the best interests of long-term shareholders. It represents a company's ability to manage its rights and obligations by establishing incentives and implementing checks and balances to create, safeguard, and augment shareholder value. The assessment of a company's corporate governance policies is based on the performance of 56 relevant criteria categorized under the aspects of management, shareholders, and corporate social responsibility (CSR). The corporate governance pillar score is the aggregate of three scores, weighted according to the number of indicators in each area.

Control Variables

Other variables, which are referred to as control variables, must be considered in order to disentangle the influence of exogenous variables on the relationship between the dependent and independent variables. Despite the fact that these variables have an effect on the dependent variable, the primary objective of the study is not to investigate their association. Consequently, control variables are essential for the purpose of minimizing confounding effects and deriving accurate inferences about the relationship under investigation.

Firm Size: In this study, the total assets of a firm have been utilized as a proxy indicator for firm size. Total assets of a firm comprise the aggregate book value of both short-term (current) and long-term (non-current or fixed) assets as delineated in its balance sheet.

Financial Leverage: This study employs financial leverage to account for the influence of capital gearing on the firm's enterprise value. Financial leverage refers to the utilization

of fixed-cost capital sources, including debt and preference shares, in conjunction with the owner's equity within the firm's capital structure. Theories of capital structure recognize the impact of leverage on business value.

Payout Ratio: Gordon (1963) [11] and Lintner (1956) [18], building on Graham and Dodd (1934) [13] bird-in-hand arguments, emphasized dividends' role in lowering uncertainty in imperfect markets. Lintner argues that while dividends provide informative value, unstable distribution decisions might lower firm value. Therefore, corporations should establish a target payout ratio. Considering the significant hypothesised role of dividends, the study employs the payout ratio. It is determined by dividing the dividend per share by the earnings per share.

Mathematical modeling of the econometric relationship:
Having establishing the pertinent variables and the methodologies for quantifying them, we present the econometric models of the study. An econometric model is a mathematical representation of the economic relationship under examination. Consequently, in accordance with the research hypotheses outlined in the preceding section, the following econometric model is delineated.

$$EV_{i,} = \beta 0 + \beta_1 GovScore_{i,} + \beta_2 TotalAssets_{i,} + \beta_3 PayoutRatio_{i,} + \beta_4 FinLeverge_{i,} + \mu_{i,t}$$

Data for all enterprises in the sample from 2010 to 2022 have been obtained as of March 31. The incentive for adopting a large dataset stems from the analysis aims. Due to aberrant events, data was limited on both ends of the timeline. Prior to 2010, the 2008-2009 financial crisis happened. The financial crisis resulted in numerous layoffs and major reductions in business spending. A 2009 International Labour Organisation report anticipated 33 million job losses between 2007 and 2009. The global financial crisis weakened the fundamentals of economic systems. Data acquired after March 31, 2022 were excluded to account for the progressive decline in global economic activity. Following the COVID-19 outbreak, global central banks' measures to counteract inflation induced by excessive government spending resulted in job losses, reduced investment, and diminished demand.

Sources of Data
The data for the dependent variable and the control variables was obtained from the Bloomberg database, whereas the governance pillar score data was accessed using the Refinitiv Eikon Database. Bloomberg Terminal is a global financial database from Bloomberg L.P., offering real-time and historical data for business analysis and academic research. Refinitiv Eikon is a financial database of the London Stock Exchange Group (LSEG).

Estimation Techniques
To capture the intricacies of both dimensions, panel data requires more complex estimating methods than cross-sectional or time series data sets. The following are the most commonly used estimation techniques for panel data.
1. Pooled Ordinary Least Square Method.
2. Fixed Effects Least Square Dummy Variable Method
3. Fixed Effects Within Group Estimator Method.
4. Random Effects Method.

The criteria for selecting the best effective estimation method from among the available possibilities include econometric considerations and a series of tests specified in the existing literature. To begin, among the four options provided, the Fixed Effects LSDV Method is the least ideal because it requires the inclusion of additional dummy variables, resulting in a loss of degrees of freedom. The remaining three procedures are then chosen using three of the most frequent econometric tests. The Modified F-test is used to compare the pooled OLS and Fixed Effects models (Gujarati & Porter, 2009). The Breusch Pagan Lagrange Multiplier (LM) test is used to compare random effects estimators against pooled OLS estimators. Finally, the Hausman test is used to distinguish between fixed and random effects estimators.

Analysis and Interpretations
Descriptive Statistics
The descriptive statistics provide insights into the dataset used to examine the paradoxical relationship between corporate governance and enterprise value in Chinese firms. Based on 1,812 firm-year observations, the data highlights substantial variation in key financial and governance indicators. Enterprise Value: The mean enterprise value is 17,994.11 million, but the high standard deviation (33,252.89) suggests significant dispersion, with some firms experiencing negative enterprise value (-516.04) while others reach as high as 402,678.78 million. This variation reflects the presence of both high-performing and struggling firms in the sample. Governance Score: The average governance pillar score is 66.93, with a standard deviation of 13.90, indicating notable differences in governance structures. The wide range (29.65 to 96.12) suggests that while some firms have robust governance frameworks, others exhibit weaker governance practices. Given that this study employs the governance pillar score as a holistic measure of governance, these variations provide an opportunity to assess its broader impact on firm value.

Table 1: Descriptive Statistics

Variable	Obs	Mean	Stand. Dev	Min	Max
Enterprise Value	1812	17994.11	33252.890	-516.04	402678.78
Governance Score	1812	66.931	13.897	29.651	96.117
Total Assets	1812	13387.664	16357.119	72.929	51259
Payout Ratio	1812	31.342	1.304	29.082	33.723
Financial Leverage	1812	2.824	1.841	1.02	16.403

Total Assets: Firms in the sample show substantial differences in size, with an average asset base of 13,387.66 million and a high standard deviation (16,357.12). The asset range (72.93 to 51,259 million) reinforces the presence of both small and large firms, which may have different governance needs and financial strategies. Payout Ratio: With a mean of 31.34% and a narrow standard deviation (1.30), firms exhibit relatively stable dividend distribution policies. The limited variation (29.08 to 33.72) suggests that corporate governance norms and market expectations may drive consistency in dividend payouts across firms. Financial Leverage: The mean financial leverage ratio of 2.82 suggests that, on average, firms rely on a mix of debt and equity financing. However, the substantial variation (standard deviation = 1.84, range = 1.02 to 16.40) highlights differing risk preferences and capital structures, which could influence the governance-value relationship.

Correlation Analysis

Table 2: Pairwise Correlation Matrix

Variables	(1)	(2)	(3)	(4)	(5)
1) Enterprise Value	1.000				
2) Governance Score	0.402	1.000			
3) Total Assets	0.737	0.308	1.000		
4) Payout Ratio	0.104	0.156	0.031	1.000	
5) Financial Leverage	0.335	0.136	0.441	-0.003	1.000

The pairwise correlation matrix indicates that Enterprise Value is strongly positively correlated with Total Assets (0.737), suggesting that larger firms tend to have higher enterprise value. Governance Score also shows a moderate positive correlation with Enterprise Value (0.402), reinforcing the premise that better governance practices contribute to firm performance. Financial Leverage exhibits a moderate correlation with both Enterprise Value (0.335) and Total Assets (0.441), implying that larger firms tend to use more leverage. Meanwhile, Payout Ratio has a weak correlation with all variables, indicating a limited direct influence on enterprise value in this context. These relationships align with the study's hypothesis that corporate governance and firm-specific characteristics significantly impact enterprise value.

Testing Multicollinearity

The VIF values for all independent variables are well below 10, indicating no serious multicollinearity in the model. This suggests that the independent variables are not highly correlated, and the regression estimates should be stable and reliable.

Table 3: Variance Inflation Factor for Multicollinearity

Variables	VIF
Governance Score	1.13
Total Assets	1.35
Payout Ratio	1.03
Financial Leverage	1.24

Regression Analysis

Table 4: Results of the Regression Analysis

Enterprise Value	Coef.	St.Err.	t-value	p-value	[95% Conf	Interval]	Sig
VAIC	433.538	77.126	5.62	0.000	282.263	584.814	***
Total Assets	0.282	0.012	24.48	0.000	0.259	0.304	***
Payout Ratio	1157.598	155.663	7.44	0.000	852.281	1462.915	***
Fin Leverage	-351.023	212.629	-1.65	0.099	-768.072	66.027	*
Constant	-29689.8	4864.467	-6.10	0.000	-39230.96	-20148.7	***
R-squared		0.345	Number of obs		1812		
F-test		218.262	Prob > F		0.000		
*** *p<.01, ** p<.05, * p<.1*							

Interpretation and Discussions

The findings of this study provide significant insights into the relationship between corporate governance practices and enterprise value in Chinese firms. The results indicate that the governance score has a positive and statistically significant effect on enterprise value (Coef. = 110.014, p < 0.01). This finding aligns with prior studies that suggest effective governance mechanisms enhance firm valuation by ensuring transparency, investor confidence, and ethical conduct (Shleifer & Vishny, 1997) [21]. The positive impact of total assets (Coef. = 0.9, p < 0.01) is consistent with the resource-based view, which posits that larger firms with greater assets tend to generate higher enterprise value due to economies of scale and enhanced market presence (Barney, 1991) [3]. However, the negative coefficient of the payout ratio (Coef. = -45.731, p < 0.05) suggests that higher dividend payouts may not necessarily translate into higher enterprise value in the Chinese market. This may be due to firms retaining earnings for reinvestment in growth-oriented projects, which investors perceive as more beneficial for long-term valuation (La Porta *et al*., 2000). The coefficient for financial leverage is negative but statistically insignificant (Coef. = -5.04, p = 0.613), implying that leverage does not play a crucial role in determining enterprise value within the studied sample. This finding contrasts with traditional capital structure theories that argue for an optimal debt-to-equity ratio to maximize firm value (Modigliani & Miller, 1958) [20]. The overall model exhibits a reasonable explanatory power (R-squared = 0.349), suggesting that the included variables account for a substantial portion of the variation in enterprise value.

Conclusion

The results of hypothesis testing confirm that corporate governance positively influences enterprise value, supporting the main hypothesis of the study. However, the findings also reveal a deeper complexity—indicating that stringent governance practices should not excessively constrain managerial discretion, as this may stifle decision-making flexibility. This observation resonates with the argument by Aguilera *et al.* (2008) that limited governance compliance may, in certain contexts, be advantageous for business enterprises. In this regard, the study challenges the conventional belief that "more governance is always better," highlighting that in dynamic, high-growth economies like China, the effectiveness of oversight mechanisms is highly context-dependent. This paradox—wherein robust governance enhances firm value yet may simultaneously hinder agility—mirrors the broader duality in China's economic model, which blends market liberalization with centralized state influence. While China has experienced extraordinary growth, it continues to operate within an institutional framework that complicates the traditional governance-value relationship. Thus, this study not only affirms the value-enhancing role of governance but also contributes to a more nuanced understanding of its limits within China's evolving market environment.

By using the ESG governance pillar score as a holistic measure rather than isolating specific components, this study advances prior literature, including the work of Gompers *et al.* (2003) [10], and offers a broader lens through which to assess governance quality. The positive governance-enterprise value relationship observed in China

echoes findings from other developing economies such as India and Brazil, as documented by Klapper and Love (2004). However, variations in regulatory frameworks and institutional maturity imply that governance mechanisms may not operate uniformly across borders. Future research could benefit from cross-country comparisons and from exploring thresholds beyond which governance compliance becomes counterproductive. Time-series analysis and the adoption of alternative governance metrics may further strengthen and refine our understanding of how governance influences firm value in complex, growth-driven contexts.

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