

The Impact of Corporate Governance on Financial Performance: Study for Portuguese Hotel Companies

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Abstract. The present work intends to analyze the relationship between the economic and financial performance of companies and the characteristics of their corporate governance. Based on Portuguese hotel companies this study analyses the importance on the performance of factors such as the size of the board of directors, women on the board, managing shareholder and the largest shareholder. Based on a sample of 3.199 observations relating to companies in the hotel sector, a Tobit regression is used to highlight the impact of characteristics of the company's governance in its performance. As far as is known, this is the first study to link economic and financial performance with the characteristics of Portuguese hotel companies. The results obtained allow us to conclude that the percentage of the largest shareholder is negatively related to the financial performance of hotel companies. In this way, the companies with the largest shareholders are the companies that show a worse financial performance. It should be noted that both the size and gender of the members on the board of directors and the fact that the shareholder is simultaneously a director are not relevant to determine the financial performance of companies in the hotel sector. The results of this study contribute to a greater understanding of how companies are governed and how it affects their performance in a specific sector with a great impact on the national economy, corporate governance affects companies in the hotel sector in Portugal.

Keywords: Hotel, Ranking, Board of Directors, Shareholders.

1 Introduction

In recent years, Portugal has witnessed a continuous and sustainable growth in international tourism. This sector is one of the most relevant sectors, impacting the growth of the Portuguese economy, contributing significantly to the trade balance, to the emergence of new infrastructures and to the creation of jobs. Thus, it is considered a

fundamental strategic axis for the sustained development of the territory [1]. Within the tourism sector, hotel symbolizes what most contributes to the sector's revenue [2].

Bearing in mind that businesses in this sector are carried out by companies, it is to be expected that this increase in the flow of tourists will be reflected in better economic and financial indicators in these companies. Thus, it becomes important to analyze the financial performance of companies in this sector, based on financial indicators such as liquidity, leverage, profitability, growth and activity. The performance evaluation will allow stakeholders to analyze the company's financial health, as well as measure the degree of competitiveness among companies in the hotel sector [3]. In the evaluation of companies in this sector, companies are hierarchized through the construction of a ranking ordered based on financial performance. This ranking makes it possible to know the classification of companies against their competitors, in order to elaborate benchmarking [4].

The financial performance of companies will tend to reflect management and owner decisions. Companies with better characteristics at corporate governance will present better decisions, will reveal less problems of information asymmetry agency, which will be reflected in a better performance. The success of a company's financial performance can be justified by the main characteristics of the board of directors and the owners. Good governance practices can lead to a reduction in costs, such as borrowing costs, an increase in company value and an improvement in risk management, with a positive impact on sustainable growth and improved company performance [5].

Several empirical studies have shown some of the characteristics of the board of directors in improving company performance. However, other studies have failed to observe significant relationships between government and company performance [5]. In another segment of tourism, [6] show a positive relationship between the percentage of ownership by the largest shareholder and company performance, as well as an inverted-U relationship between the size of the board of directors and company performance. Thus, this article studies whether the companies with the best results in the ranking of financial performance are related to some of the characteristics of the board of directors and shareholders. As far as is known, there are no studies in the literature that analyze the relationship between the performance rankings with the characteristics of the board and shareholders, in the hotel sector in Portugal, which represents an innovative contribution to the literature.

The article is organized into four sections. Next, the literature review is presented. In the second section, we present the methodology. Subsequently, we present the empirical study and discussion of the results. Finally, the main conclusions of the study, limitations and avenues for investigation are at the end.

2 Literature Review

2.1 Financial Performance

The evaluation of companies' financial performance has a huge importance not only for managers, creditors, financial specialists and current or potential investors, but also for competitors in the same sector of activity [7], [8]. The companies' performance can

be an indicator that estimates how well an organization performs the established objectives [8].

The performance evaluation can help the company's management in decision-making, as through the evaluation of the performance of previous years, they are challenged and motivated to improve the company's performance every year [9]. In addition, it allows companies to compare their performance with that of others so that they can remain active in their competitiveness in the market [10]. Therefore, performance evaluation is one of the most efficient tools to assess the economic and financial situation of each company, allowing one to determine the condition in which each company is or has already been found [11]. This assessment has proved to be a crucial technique for deeply competitive industries [12].

The companies' performance evaluation is usually based on the companies' financial reports in order to know their financial and economic performance and the risks, as well as to foresee future events. This information is of great importance to various stakeholders, such as financial institutions, investment and commercial organizations, governments and management [13]. Thus, performance can be measured through, for example, return, productivity, production and economic growth [8], [12], the fulfillment of budgetary objectives [14], or applying the resources at their disposal to generate revenue [15]. This performance evaluation approach has been distinguished as the most powerful and relevant to carry out performance evaluation over a long period of time [9].

2.2 Agency Theory

Agency theory discusses the problems that arise in companies due to the separation between owner and management [16]. Thus, agency theory concerns an existing contract between two agents, namely between the principal (owner) and an agent (management). This relationship arises when the shareholder delegates in the manager the decision-making. Thus, the business owner expects managers to act in his interests and on his behalf, maximizing his well-being. However, the difference in interests between management and ownership of the company may cause additional costs, known as agency costs. Agency costs refer to the costs incurred by shareholders to monitor managers to avoid actions that may cause them harm, the incentives given to managers to prevent them from taking actions that are against the interests of the owner, and the residual loss caused by sub-optimization of the manager with the objective of maximizing his well-being [17].

In the business context, agency costs arise essentially due to the asymmetry of information between the owner and the managers [18]. Thus, despite management wanting salary increases, bonuses, and increased job security in the face of the threat of dismissal [19], managers prefer to prioritize his wealth over maximizing the welfare of the owner in the presence of asymmetries of information, thus promoting their own interest at the expense of shareholders [52]. By making the company bigger, showing faster growth or performing better than expected, the manager's status will increase [19].

Therefore, management compensation generates a powerful incentive to manipulate corporate earnings to improve their financial statements [20].

2.3 Dependence Resource Theory

The dependence resource theory states that a company cannot sustain itself due to limited resources, leading it to relate to the external environment so that it can grow and develop activity [21]. However, the board of directors emerges as a means that helps the company, leading to a reduction in dependence on the external environment, since the board exploits essential external resources, such as technology, relevant information and human and financial capital [22]. These resources are able to improve the efficiency of the company's decision-making [22] and reduce the costs associated with transactions [23]. Thus, reducing the company's dependence on the external environment allows the company to improve its performance and ensure its survival [23].

The dependence resource theory allows to justify the benefits of large boards, the presence of women, qualified directors and foreigners with the fact that boards with these characteristics have more connections with the external environment of the company [24]. Based on this theory, companies expand their boards of directors to increase their ability to acquire external resources, to hold a greater diversity of knowledge and a greater connection with the outside world [25].

In this way, the dependence resource theory sustains that a board assists the company in the channels of communication with the external environment, advises and advises the company in specific areas, legitimacy and enables the company to obtain access to necessary resources in a preferential way [26]. Thus, these resources are fundamental to the success of innovation, facilitating greater investments in R&D by the company [27], in which they add value to the company and contribute to performance [28]. Therefore, a larger board is likely to be more effective in securing the interests of shareholders [29], more likely to see greater diversity with respect to experience, skills, gender and nationality ([30].

2.4 Corporate Governance

Corporate governance may be relevant within agency theory and resource dependence theory to determine the ranking of financial performance. Thus, several characteristics must be analyzed.

In companies with concentrated ownership, agency problems are expected because a majority shareholder may exercise their power to expropriate the gains of minority shareholders [31]. Large shareholders can affect the company's behavior when they engage in ownership control [32], as they have the capacity to acquire private benefits, transferring company resources out of the company, thus undermining the company's value [33]. The agency problem between the majority shareholder and minority shareholders [34] may be related to the fact that large shareholders can manipulate and obtain private profits to maximize their personal wealth at the expense of other shareholders. If large shareholders obtain financial resources for themselves, the value of the company will be lower [32]. However, large shareholders may have an inverse role for the

company's value, if they adequately perform the role of monitoring and restricting activities that harm their wealth. Thus, the existence of large shareholders can result in lower agency costs and increased company performance [32].

Based on [32] conclusion that large shareholders can effectively bring negative consequences for minority shareholders and board members when seeking new financing, the following research hypothesis is studied for the accommodation sector:

H1: The financial performance of companies is negatively associated with the percentage of capital held by the largest shareholder.

The board of directors develops its activity in the best interests of the shareholders, although they also have their own objectives that may lead to agency problems, with an impact on improving the financial performance of companies [35]. Given the need to create balance among all members in defending the interests of the owners, minimizing agency costs, the size of the board of directors can influence the decision-making process, as well as the efficiency of the board [36].

There is no consensus in the literature regarding the ideal size of the board of directors. On the one hand, there are authors who argue that boards of directors with more members are more inefficient due to being more prone to the emergence of conflicts of interest and more difficult to reach a consent [37]. Smaller boards of directors are more cohesive and effective [29] and easier to organize, yet more difficult for the CEO to control [38]. However, on the other hand, from the perspective of dependence on resources, larger boards of directors can lead to a better connection between the company and the external environment [39].

Thus, the empirical results are not homogeneous. [23] concluded that an increase in the size of the board of directors can have a positive association with the financial performance of the company, while [40], [41] show an inverse association between company financial performance and company board of directors [40], [41]. Within the scope of companies in the hotel sector, we seek to understand whether:

H2: The size of the board of directors is negatively related to the financial performance of the company.

The division between management and ownership is pointed out as a source of potential conflicts of interest in companies [42]. However, when the directors of a company hold shares, there tends to be an alignment of interests between shareholders and directors because they are the same person [43]. According to the agency theory, companies should adopt a series of incentives in order to mitigate this problem [17], so that management assumes values-maximizing behaviors that do not damage the company's performance [42]. One of the most common ways to minimize conflicts of interest is through financial compensation to board members [44].

When shareholders and managers do not have interests aligned with maximizing wealth, substantial agency costs tend to arise [17]. Based on financial theory, one of the ways to eliminate or strongly minimize conflicts of interest between management and shareholders is related to the fact that the members of the board of directors are simultaneously shareholders. In this case, the personal interest of the manager is totally (or tends to be totally) coincident with the personal interest of the shareholder. Thus, greater internal ownership reduces agency costs and results in better firm performance [45]. Thus, with the aim of clarifying the importance that the shareholder being simultaneously a manager can have on the financial performance of the company, it is analyzed whether:

H3: Companies with directors who are simultaneously shareholders show better financial performance.

Traditionally, boards of directors have only male members [24]. However, in recent years, the diversity of members on the board of directors has been attracting attention, with discussions about the effects of women's participation in companies. It should be noted that, in developed countries, there has also been an increase in regulations regarding the increase of the role of the female figure on boards of directors, in a way that ensures gender equality on the board [46].

According to [47] the diversity of members on the company's board of directors can allow the company to improve its performance, as the company's problems are seen from different perspectives, leading to the presentation of several solutions to the same problem. Female board members are considered more independent and more beneficial to the board, compared to the opposite gender [48], as women are more dedicated to their tasks. Thus, the diversity of members on the board of directors is considered an essential element to improve the value and financial performance of the company, as it provides new points of view, knowledge and the ability to concentrate on several things at the same time [48],[47]. As such, it is intended to understand whether in the hotel sector:

H4: The percentage of women on the companies' board of directors is positively related to financial performance.

3 Methodology

In order to analyze the effect of governance characteristics on the financial performance of Portuguese hotel companies, it was necessary to collect economic and financial information about companies, as well as information about their owners and board of directors. This information was collected from the SABI database, in the period 2019 and 2020, that were in an "active" situation and with a turnover higher than €100,000. From here it was possible to obtain data from 4,206 companies corresponding to a total of 8,412 observations. However, because some observations had missed data and the creation of the dependent variable, the database have 3,199 companies.

Considering the objective and the research hypotheses developed, a regression model is formulated with the following specification:

$$Scor_{i,t} = \beta_0 + \beta_1 \%CAP_{i,t} + \beta_2 AD_{i,t} + \beta_3 ADAC_{i,t} + \beta_4 WOM_{i,t} + \beta_5 DIM_{i,t} + \beta_6 AGE_{i,t} + \beta_7 ATF_{i,t} + \varepsilon_{i,t} \quad (1)$$

Where: $Scor_{i,t}$ - Scoring of the company_i in year_t, calculated by the combination of FAHP-TOPSIS methods; $\%CAP_{i,t}$ - Percentage of capital held by the majority shareholder on the company_i in year_t; $AD_{i,t}$ - Size of the board of directors in the company_i in year_t; $ADAC_{i,t}$ - Dummy variable that takes the value 1 if the shareholder is also a manager of the company_i in year_t, and 0 otherwise; $WOM_{i,t}$ - Percentage of women on the board of directors in the company_i in year_t; $DIM_{i,t}$ - Size of the company_i in year_t, represented by the logarithm of total assets; $AGE_{i,t}$ - Age of the company_i in year_t; $ATF_{i,t}$ - Ratio of tangible fixed assets to total assets in the company_i in year_t.

The dependent variable in this study is the Scoring, which was constructed according to the study of [49]. This variable uses the results of that study. Thus, an economic-financial ranking of hotel companies in Portugal in 2020 was calculated based on a hierarchical model for evaluating financial performance, that was structured based on criteria and sub-criteria of liquidity, leverage, profitability, growth and activity. Each of these criteria and sub-criteria are evaluated and weighted using the Fuzzy Analytic Hierarchy Process (FAHP) model. Then, these weights were used to classify the companies using the Technique for Order Preference by Similarity to Ideal Solution (TOPSIS), thus obtaining the ranking or scoring.

As the scoring variable presents values within an interval of 0 to 1, which characterizes the dependent variable, the Tobit estimation approach is adopted for the empirical study.

Tobit models refer to a regression model in which the range of the dependent variable is limited [50]. This statistical model was proposed by James Tobin in 1958, with the aim of explaining the relationship between a dependent variable and independent and latent variables [51]. They are also known as censored or bounded 0 to 1 regression models. The standard structure for a Tobit estimation is represented in Equations (1) and (2).

$$y_{i,t}^* = \alpha_0 + \beta X_{i,t} + \varepsilon_{i,t} \quad (2)$$

Where $y_{i,t}^*$ is a latent variable, $X_{i,t}$ is the observed $1 \times k$ vector of explanatory variables and $\varepsilon_{i,t} \approx i. i. d. N(0, \sigma^2)$ and is independent of $X_{i,t}$. Unlike looking at $y_{i,t}^*$, we observe $y_{i,t}$:

$$y_{i,t} = y_{i,t}^*, \text{ if } y_{i,t}^* > y; = 0, \text{ if } y_{i,t}^* \leq y \quad (3)$$

Where y is a non-stochastic constant, while the value of $y_{i,t}^*$ is absent when it is less than or equal to y . It should be noted that the Tobit model is usually based on the following assumptions: (i) the presence of an unlimited latent adoption variable that reflects a linear function of the forecast indicators and (ii) the residuals are characterized by a normal distribution [53].

4 Results and Discussion

This study seeks to understand whether companies in the accommodation sector with better financial performance are associated with the characteristics of the board of directors and shareholders. In addition to these corporate governance characteristics, other business characteristics are also analyzed, namely size, age and tangibility. Table 1 presents some descriptive statistics of the variables used.

Table 1. Descriptive statistics.

Variable	n	Average	Standard Deviation	Minimum	Maximum
$Scor_{i,t}$	3199	0,347	0,007	0,185	0,471
$\%CAP_{i,t}$	3199	0,669	0,263	0,000	1
$AD_{i,t}$	3199	2,912	2,135	1	19
$WOM_{i,t}$	3199	0,321	0,323	0,000	2
$DIM_{i,t}$	3199	13,390	1,850	7,112	19,700
$AGE_{i,t}$	3199	18,060	15,523	3	122
$ATF_{i,t}$	3199	0,506	0,331	0,000	0,996
		Dummy	n	%	
$ADAC_{i,t}$	3199	1	2680	83,6	
		0	527	16,4	

Source: Own elaboration

The descriptive statistics in Table 1 show that, on average, the financial performance of accommodation companies is situated at 34.7% of the ranking, reaching a maximum of 47.1% and a minimum of 18.5%. The average percentage held by the majority shareholder in the companies under analysis is 67.0%, with a standard deviation of 26.3%. The board of directors have, on average, 2,912 members, with this variable being between 1 and 19 members. On average, 32.1% of the companies in this study have women on the board of directors. Table 1 also evidence that in 83.6% of the observations the owner also performs functions in the board of directors or in the management of the company. The companies in the sample exhibit an average age of 18.06 years. As for the ATF indicator, this presents an average of 50.6%.

Next, Table 2 presents the Pearson correlation coefficients estimated for the variables under analysis. With regard to the analysis of the translated correlation coefficients, it can be seen that the ranking value (SCOR) is positively correlated with the variables: women on the board (WOM) and managing shareholder (ADAC). It is also possible to verify that the ranking value (SCOR) is negatively correlated with the remaining variables under study. The correlation between the variables board size and dimension is the strongest correlation in the study (54.3%). The next strongest correlation is 37.1% between board size and age.

Table 2. Pearson correlation coefficients.

Variables	$SCOR_{i,t}$	$\%CAP_{i,t}$	$AD_{i,t}$	$ADAC_{i,t}$	$WOM_{i,t}$	$DIM_{i,t}$	$AGE_{i,t}$	$ATF_{i,t}$
$SCOR_{i,t}$	1	-0,020	-0,079	0,070	0,033	-0,161	-0,067	-0,116
$\%CAP_{i,t}$		1	-0,235	-0,070	-0,077	-0,038	-0,145	-0,166
$AD_{i,t}$			1	-0,555	-0,152	0,543	0,371	0,108
$ADAC_{i,t}$				1	0,210	-0,535	-0,264	-0,051
$WOM_{i,t}$					1	-0,209	-0,043	0,008
$DIM_{i,t}$						1	0,362	0,309
$AGE_{i,t}$							1	0,101
$ATF_{i,t}$								1

Source: Own elaboration

Table 3 shows the estimation results of five Tobit regression models, where governance variables are used one by one individually and the last model use all variables together. The estimation of the Tobit regression model shows three statistically significant variables: %CAP, DIM and ATF. The analysis of the regression coefficients reveals that, for a significance level of 5%, the percentage of the majority shareholder is negatively related to the financial performance of companies (SCOR). Thus, companies in which the majority shareholder has a significant percentage of participation are those with the worst results in terms of financial performance, thus confirming H1. Validation of H1 corroborates the results of the study developed by [32], as companies with large shareholders are those whose company value is lower, due to the assumed behavior of these shareholders.

Table 3. Performance and corporate governance.

Variable	(1)	(2)	(3)	(4)	(5)
Const.	35,558 ***	35,501 ***	35,538 ***	35,475 ***	35,632 ***
$ADAC_{i,t}$			-0,022		-0,042
$WOM_{i,t}$				0,014	0,010
$AD_{i,t}$		0,003			-0,004
$\%CAP_{i,t}$	-0,107 **				-0,118 **
$AGE_{i,t}$	-0,001	-0,001	-0,001	-0,001	-0,001
$ATF_{i,t}$	-0,177 ***	-0,166 ***	-0,164 ***	-0,168 ***	-0,175 ***
$DIM_{i,t}$	-0,052 ***	-0,055 ***	-0,056 ***	-0,053 ***	-0,054 ***
n	3199	3199	3199	3199	3199

Notes: This table presents the results of Tobit estimation for the Scoring dependent variable. It is shown the variable coefficient. ***, ** and * refers to the statistical significance of 1%, 5% and 10%, respectively.

Source: Own elaboration

As expected, the AD variable has a negative coefficient, but it is not statistically significant. The ADAC variable, however, does not show the expected sign (positive sign) nor is it statistically significant. This result show that these variables do not contribute to explain the financial performance (SCOR) of companies, thus not proving H2 and H3. For the variable MULH, as expected, it was possible to find a positive coefficient, however it is not statistically significant. That is, the percentage of women on the board (WOM variable) does not help to explain the financial performance (SCOR) of companies, thus not validating H4.

About the control variables, only DIM and ATF variables help to explain the model. The results evidence that there is a relationship between the dimension (DIM) and the ranking (SCOR), for a p-value < 0.01. The same is true for the relationship between the indicator that evaluates the business model (ATF) and the ranking (SCOR). However, the AGE control variable does not contribute to explain the ranking value, since it is not statistically significant.

5 Conclusion

In Portugal, the hotel sector has been growing and gaining an increasingly key role. Thus, the main objective of this study was to analyze the characteristics of companies, more specifically, the characteristics of the board and owners, which most contribute to the financial performance of Portuguese companies in the hotel sector.

Based on data from the years 2019 and 2020 for companies in the hotel sector, the results obtained by the Tobit regression show that the characteristics that most contribute to financial performance are %CAP, DIM and ATF, that is, the value of ranking is only statically explained by these variables. The majority shareholder of the company shows a negative and significant relationship with the ranking, according to the expected trend, that is, the hotel companies where the majority shareholder has a significant percentage (above average) have a worse financial performance. Validating in this way the H1. As for the remaining investigation hypotheses, it was not possible to validate them, as they are not statistically significant, but presented the expected coefficient sign, with the exception of the ADAC variable. Finally, the dimension and the AFT/Total assets indicator showed a significant and negative relationship with the ranking.

This investigation contributes to a better knowledge of the type of characteristics of the board of directors and ownership present in Portuguese companies from hotel sector when evaluating their financial performance.

Finally, for future studies we suggest the analysis of other characteristics of the board of directors and other characteristics of ownership for Portuguese hotel companies. Additionally, we recommend applying this study in other Portuguese industries.

Conflict of interest: The authors declare that there is no conflict of interest.

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