

# Research on the Relationship between Corporate Governance and Corporate Value

## -- Based on Eva Evaluation Index

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### Abstract

**This article uses the performance evaluation index of EVA (economic value added) to measure the value of the company, and from the ownership concentration in corporate governance, the board of directors governance, market management incentive, and control four aspects, choose deep Shanghai A-share listed companies from 2008 to 2016 to do sample explores the model discuss the relationship between corporate governance and the value of the company inspection, The conclusion is that corporate governance is positively correlated with corporate value.**

### Keywords

**Company Value; Corporate Governance; Economic Added Value.**

### 1. Introduction

Corporate governance is the key to the relationship among control, supervision, management, and decision-making in the development of enterprises, hoping to maximize corporate interests. Therefore, the relationship between corporate governance and corporate value has become the focus of scholars at home and abroad. For example, Zhan Wei (2014) [1], Jensen and Meckling (1976) [2] found that when the level of corporate governance is low, most of the reasons for the decline of enterprise value can be summarized as that one share is dominant and the interests of minority shareholders are seized. Owners are unable to restrain actual managers, and shareholders' interests suffer damage. Also, corporate governance level is high, medium and small shareholders have a certain influence in the decision-making, shareholders may by the board of directors governance, constraint to management, ensure the direction of management activity based on value maximization, in addition, but also by various means such as bonus for the management of incentive, unifying the management benefit and value of the company, So that the interests of operators and owners to achieve the same level, enhance the value of the company.

At present, there are many methods to measure corporate value. For example, Gong Zhiwen (2010) [3] used traditional accounting performance indicators such as the rate of return on total assets and return on equity to study corporate value. It is easy to ignore the opportunity cost of capital when the traditional accounting performance index is used to calculate the value of a company, which leads to a great difference between the calculation result and the real situation. For another example, Wu Wei (2008) [4] used Tobin's Q value to study the relationship between corporate governance and corporate value. Tobin's Q value is equal to the ratio of the market value of the listed company's stock to the replacement cost of its assets. It is difficult to accurately calculate the market value and replacement cost, and the price of China's stock market fluctuates greatly. So, it is very difficult to calculate Tobin's Q value. Therefore, no

matter the traditional accounting performance index or Tobin's Q value to calculate the enterprise value will have a large error.

1982 Stern Stewart & Co., an American consulting firm, Economic Value Added (EVA) is a measure of firm Value, which takes into account all capital costs including opportunity costs that can bring profits in the process of business operation. Sun Li (2014) [5] showed that EVA had two advantages over traditional accounting indicators: first, it considered the opportunity cost of capital; Second, the traditional accounting procedures have been adjusted to effectively alleviate the distortion of accounting. Wang Panna (2009) [6], Xue Lan (2015) [7] et al believe that traditional "accounting profit" is ex-post profit, and EVA is a supplement to traditional "accounting profit". Cai Jiali (2013) [8] believes that traditional accounting indicators do not consider capital opportunity cost, and EVA is more reasonable than traditional accounting to measure enterprise value.

Based on the above, this paper uses the EVA performance evaluation method to measure corporate value and takes the data of A-share listed companies in Shenzhen and Shanghai from 2008 to 2016 as samples to empirically analyze the correlation between corporate governance and corporate value.

## 2. Research Design

### 2.1. Research Hypothesis

Based on the following literature, this paper puts forward five hypotheses on the possible relationship between corporate governance and corporate value from four aspects: ownership concentration, board governance, management incentives, and control market, and uses EVA (Economic Value Added) as the value evaluation index to measure corporate value. The relationship between enterprise governance and enterprise value is explored.

Lou Quan (2004) [9] and Ma Fang (2016) [10] found that when the proportion of shares held by major shareholders is greater than 45.9%, the major shareholders because they own most of the company's equity, can improve the incentive and supervision ability of the management and have a more significant effect. At the same time, to strive for the interests of the enterprise, they will make full use of all resources. That is, the Alignment Effect is produced. Therefore, this paper proposes hypothesis H1: the degree of equity concentration has a positive relationship with corporate value.

Zhou Jian (2016) [11] and Pan Yongxin (2012) [12] believed that the main responsibilities and functions of the board of directors were to represent shareholders to exercise the supervisory power over the management, exercise the decision-making power over the company, and establish the incentive system for the management, etc. Therefore, the larger the size of the board of directors, the greater the role of its supervisory power and decision-making power, and the greater the role of corporate value. Therefore, hypothesis H2 is proposed: there is a positive relationship between the size of the board of directors and corporate value.

Wei Gang (2007) [13] and Tan Jinsong (2003) [14] believed that independent directors, with their unique independence, not only played an important role in the protection of shareholders' rights and interests and participation in performance evaluation but also had a restrictive relationship with insiders in an enterprise. Preventing shareholders from taking advantage of their control over the company to do some behaviors that harm the interests of other shareholders and are not conducive to the development of the company also plays a certain role in preventing shareholders' meetings and board of directors from being manipulated by large controlling shareholders. Therefore, hypothesis H3 is proposed: the proportion of independent directors has a positive relationship with corporate value.

Zhan Lei (2013) [15] believes that it is essential to give appropriate incentives to the management to make the business operators share the same goal with the business owners and make the business operators carry out business activities with the interests of shareholders as the priority. Executive compensation incentive is one of the important aspects. The greater the individual contribution is, the higher the compensation can be, which is conducive to stimulating the enthusiasm of managers and forming a directly proportional relationship between managers' compensation and corporate value. Therefore, the following hypothesis H4 is proposed: executive compensation has a positive relationship with corporate value.

Pan Yongxin (2012), Chen Hong (2005) [16], and Lu Yao (2010) [17] believe that a competitive market for corporate control can constrain the management, thus forcing the managers to work harder to improve the value of the company. Therefore, this paper puts forward the following hypothesis H5: there is a positive relationship between the control right of shareholders and the value of the company.

## 2.2. Sample Data and Model Establishment

The data samples used in this paper are all from A-share listed companies in Shenzhen and Shanghai. The sample interval is from 2008 to 2016, and the total number of samples is 9,724. Among them, ST companies, companies that have stopped listing, companies with severe losses, and some companies with incomplete data have been excluded, and the total number of samples is 9,724.

In this paper, EVA is selected to measure the value of the company, which is taken as the explained variable. In addition, the variables used by Pan Yongxin (2012) and Chi Zheng (2017) [18] were used as explanatory variables to measure the level of corporate governance. Multiple regression model is used to study and discuss the relationship between corporate governance and corporate value. The model is as follows:

$$EVA = \beta_0 + \beta_1 * CON + \beta_2 * BODS + \beta_3 * IND + \beta_4 * HMP + \beta_5 * TOP10 + \beta_i * \sum ind_i + \beta_j * \sum year_j + \epsilon$$

The variables in the above model and their definitions are shown in Table 1.

**Table 1. Variables and their definitions**

Variable types	The name of the variable		symbol	instructions
Interpreted variable	Economic added value		EVA	The residual profit after deducting all production factors to undertake. Its calculation formula is: EVA= net operating profit after tax (NOPAT) - total invested capital (TC) × weighted average cost of capital ratio (WACC)
Explain variables	Degree of ownership concentration		CON	The sum of the square proportions of the top 10 shareholders
	Board governance	Board Size	BODS	The number of directors reflects the size of the board
		Proportion of Independent Directors	IND	Proportion of Independent Directors Number of Independent Directors/Number of Directors
	Management incentive		HMP	The total compensation of the top three senior managers with the highest amount shall be taken as the natural logarithm
Market of control		TOP10	The shareholding ratio of the second to tenth largest shareholders	

### 3. Empirical Results and Analysis

Table 2 shows the regression analysis results. The Con regression coefficient of ownership concentration is 0.315092, which is significantly positive at the 1% level. Therefore, Hypothesis 1 is verified. This is consistent with the results obtained by Chi Zheng (2017) and Zhang Ning (2017) [19]. The higher the ownership concentration degree is, the better the consistency of the interests between the shareholders and the enterprises. It can urge the owner of the enterprise to pay more attention to the development of the enterprise and make the decision that can promote the development of the enterprise better, which is conducive to the improvement of value.

This paper reflects the relationship between board governance and corporate value through the size of the board of directors, BODS, and the proportion of independent directors, IND. The regression coefficients of BODS and IND were 0.0116156 and 0.245404 respectively, both of which were significantly positive at the 1% level, that is, hypotese 2 and 3 were verified to be valid.

The HMP regression coefficient of management incentive is 0.0419621, which is significantly positive at the 1% level. Therefore, Hypothesis 4 is verified. This is consistent with the results of Chi Zheng (2017). It shows that salary incentives can increase the enthusiasm of senior managers and create value for the company.

Finally, the regression coefficient is 0.0388234, which is significantly positive at the 10% level, using the Top10 index to reflect the control market. Therefore, Hypothesis 5 holds. The controlled market can remove and replace the managers who fail to maximize the enterprise value to put pressure on the management to achieve the effect of improving the enterprise value. Based on the above research results, it can be seen that there is a positive relationship between corporate governance and corporate value, it is the improvement of corporate governance level is more conducive to the improvement of corporate value. This paper is consistent with the results obtained by Xu Cai (2017) [20].

**Table 2.** Model regression analysis

(Dependent variable): EVA	Coefficient	Std. Error	t-value	p-value	
const	-0.852635	0.249282	-3.420	0.0006	***
CON	0.315092	0.0217086	14.51	<0.0001	***
BODS	0.0116156	0.00160046	7.258	<0.0001	***
IND	0.245404	0.0500118	4.907	<0.0001	***
HMP	0.0419621	0.00372770	11.26	<0.0001	***
TOP10	0.0388234	0.0204081	1.902	0.0572	*
Industry, Year	control	observations	9724		
Adjusted R-squared	0.086277	R-squared	0.089003		

Note: \*, \*\* and \*\*\* indicate significant at the level of 10%, 5% and 1%, respectively

### 4. Conclusions and Suggestions

This paper selects A-share listed companies from 2008 to 2016 as samples measure corporate value based on EVA economic increase and conduct empirical research and discussion on the relationship between corporate governance and corporate value from five perspectives: ownership concentration, the board size, the proportion of independent directors, management compensation incentive, and control market. In this paper, through the establishment of the regression model, and the regression results to explore thinking, finally draw the conclusion: ownership concentration, the board size, independent directors' proportion, executive

compensation incentive, control the market on the value of the company present significant positive influence, as a result, this paper can be concluded that the value of the company by the positive influence of corporate governance.

Through empirical research, it proved that the improvement of corporate governance mechanism is of great help to the increase of enterprise value. This paper makes further summary and suggestions as follows:

(1). To enhance corporate value, listed companies should properly collect equity so that the interests of major shareholders are in line with the trend of the company. They will pay more attention to the long-term development and profitability of the company and improve the initiative of shareholders to supervise the operation of the company, which is conducive to the promotion of corporate value.

(2). Strengthening board governance, expanding the scale of the board of directors, and introducing more experienced independent directors can enhance the value of the company. Appropriately increase the number of directors, expand the scale of the board of directors, so that they play a wider and stronger role in the supervision and decision-making in the process of business. If the listed company can appoint and introduce more experienced independent directors, it will be helpful to enhance the value of the company.

(3). Salary incentive is conducive to talent management, development, and value enhancement of the company. In the process of self-development and value enhancement, enterprises should adopt corresponding a salary incentive system, which can better stimulate managers' passion for work and create conditions for the company to introduce excellent talents.

(4). Keep the market for control active and prevent companies from feeding "useless" executives. The controlled market can give operators benign oppression, promote the management to develop a sense of crisis, and urge them to make efforts to maximize the value of the company.

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