

The Impact of Corporate Governance Practices on Financial Performance in Western Balkan Countries



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ABSTRACT

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This study focuses on assessing the impact of the corporate governance practices of seven Western Balkan countries on their financial performance. Specifically, to investigate the specific relationship between them, we used measures of corporate governance such as the index of disclosure, liquidity and leverage, while to assess financial performance, we utilised return on assets and return on equity. We applied quantitative methods using secondary data. The data were extracted from the published reports of institutions such as the World Bank (WDI), the International Monetary Fund, and the central banks of the respective countries, as well as case studies and foreign literature in this field. Linear regression, fixed-effects, random effects and trend analysis were used to test the hypotheses, and this study will cover a period of five years. From the generated results of the models, we can conclude that the financial leverage and the index of financial disclosures positively influence the financial performance of the Western Balkan countries. We present real and consistent results regarding corporate governance practices' impact on Western Balkan countries' financial performance. Extracting data from the reports of WDI and CB and adhering to international literature allows us to draw competent conclusions and recommendations in this area.

1. INTRODUCTION

As a result of the great financial crisis of 2007–2008, the issue of corporate governance has been at the centre of debates among policymakers, regulators, economists, businesses and communities in almost all countries of the world. Corporate governance is considered to be highly important in developing and developed economies due to its connection with organisational, financial, economic, social and environmental aspects. Corporate governance can be defined as the system by which companies are directed and managed to achieve high financial performance [1]. It defines a set of relationships between a company's management, its board, and its shareholders and stakeholders [2]. Corporate governance consists of a set of rules, controls, practices and processes by which a company is managed, including the relationships between various stakeholders and the company's objectives. Good corporate governance practices aim to promote transparency and public accountability [3]. They increase management accountability through enhanced disclosures to protect the interests of various stakeholders, leading to better functioning of the company. Through public accountability, managers and organisations become more accountable to the public, community interest groups and individuals [4]. The availability of financial reporting disclosures is considered a key determinant of the efficiency of resource allocation decisions by investors. The provision of information is essential for investors and other interested parties because they

use this explanatory information for their economic decisions regarding the business enterprise.

From this, we can conclude that good corporate governance through the use of internal mechanisms and sound practices improves the company's image, increases the confidence of shareholders and reduces the risk of fraudulent activities. The remainder of the paper is organised as follows. The first section includes the theoretical literature and empirical findings. Section 2 presents the methodology and techniques of qualitative and quantitative data collection, the drafting of the hypotheses and the econometric model specification. In Section 3, an analysis of linear trends is provided. Section 4 describes the econometric analysis and discusses the results of the study. Finally, Section 5 outlines the conclusions.

2. LITERATURE REVIEW

In this section, the works of different authors in the field of corporate governance and financial performance will be analysed in theoretical and empirical terms. Within this literature review, we will include the concepts of corporate governance and governance mechanisms and their role in financial performance. We will link this study with the agency and administration theories which largely explain corporate governance and the avoidance of problems that may occur as a result of non-genuine corporate governance. Corporate governance refers to the systems, mechanisms, processes and

structures by which companies are managed and directed [5]. It also includes reviewing the organisation's practices and policies regarding ethical standards and principles and compliance with its code of conduct [6]. The Cadbury Committee on Corporate Governance defines corporate governance as the process and structure used to direct and manage the company's business affairs towards increased prosperity and the accounting of the corporation with the ultimate objective of realising long-term shareholder value, taking into consideration the interest of other interested parties known as stakeholders (the board of directors, management, employees, customers, suppliers and the community) [7]. Corporate governance identifies the role of directors and auditors in relation to shareholders and stakeholders. It is important for shareholders as it increases confidence in the company for a better return on investment. For stakeholders such as employees, customers, suppliers, the community and the environment, corporate governance ensures that the company behaves in a socially and environmentally responsible manner [8]. The corporate governance system of modern corporations is divided into two parts, namely, the internal and external governance mechanisms. Internal corporate governance mechanisms include the degree of shareholder concentration or ownership structure, such as the percentage of institutional shareholders and foreign, external and internal shareholders. It also relates to the composition of the board of directors, such as board size, board composition (the percentage of non-executive directors), board committees and board leadership structure [9]. Three types of board-level committees – audit, nominating and remuneration – are most commonly required by law or recommended by corporate governance codes in most jurisdictions [10]. Auditing is a systematised process of collecting and creating arguments in relation to economic activity. It results in ascertaining the balance between the enterprise's business and the previously presented criteria, and the information is sent to interested users [11].

On the other hand, external governance mechanisms consist of the capital market, the public sector, legislation and the labour market [12]. Consequently, corporate governance mechanisms are issued by national and international authoritative bodies. These mechanisms contain principles or legislation for good corporate governance mechanisms that major or listed companies are encouraged or mandated to adopt or implement [13].

2.1 Agency theory

To investigate the effect of corporate governance (relationships between owners and managers) on financial performance, we used agency theory as a theoretical framework. Agency theory represents the most popular theoretical perspective of corporate governance. Authors define the agency relationship as a contract under which one party (the principal) engages another party (the agent) to perform certain services on their behalf [14, 15]. Moreover, they add that shareholders are the managers and managers are the agents who work on behalf and for the interests of the managers. Agency problems arise when management and shareholders have different goals, and monitoring management's activities is difficult and costly for shareholders [16]. The presence of an asymmetry of information and self-interest between shareholders and agents means that principals have no reason to trust their agents, leading to increased

concerns about the reliability of the information provided by the agent and the degree of trust placed by principals in their agents, resulting in increased agency costs. These agency costs are even higher in countries with weak investor protections and ineffective legal systems [17]. Useful and effective corporate governance mechanisms can help to control the rift between management and shareholders [18]. Better corporate governance reduces agency costs, increases investor confidence, improves firms' access to cheaper financing sources, and reduces the need to use leverage to discipline managers [19]. Corporate governance mechanisms such as the ownership structure, managerial ownership, board of directors, debt financing and financial information quality affect the mitigation of agency problems [20]. In addition, as it involves a high audit quality and the reduction of information asymmetry, corporate governance positively affects the attraction of new investments. It leads to a rise in the volume of investments in companies, which increases the company's value [21].

2.2 Stewardship theory

Stewardship theory was introduced as a normative alternative to agency theory [22]. Like agency theory, stewardship theory emphasises the need to align principal and agent goals, but unlike agency theory, stewardship theory assumes that boards and managers are stewards whose behaviour is automatically aligned with their principals' objectives [23, 24]. Stewardship theory suggests that owners' interests are aligned with those of managers since managers are custodians or administrators of the firm. So, managers/directors have a fiduciary duty to the shareholders of the company in which they are employed [25]. Managers are expected to increase performance to ensure higher profits, as they are imbued with the desire to protect the interests of shareholders and ensure the continued prosperity of the firm.

2.3 The impact of corporate governance practices on financial performance

In general, corporate governance is considered to be an important variable affecting an economy's growth prospects because better governance practices reduce the risk for investors, improve financial performance and help attract investors [26]. Companies with good corporate governance have a greater shareholder value due to a higher cash flow and reduced cost of capital [27]. If corporate governance is considered good, it reduces the cost of capital to the extent that it reduces shareholders' monitoring and auditing costs [28]. Conversely, companies with weak corporate governance structures cannot guarantee shareholders sustainable wealth creation, as governance mechanisms will be insufficient to hold executives accountable for their stewardship [29]. The fundamental objective of good corporate governance is to promote transparency and public accountability [30]. The more transparent the companies' activities, the more accurately their securities will be valued in the markets [31].

Additionally, disclosing corporate governance practices provides investors with information about the corporate ownership structure, management structure, management composition, and internal audit and control [32]. On the other hand, this reporting of governance practices also enables corporate managers to provide information on how they carry out their responsibilities to their stakeholders, otherwise

known as their accountability. Analysis from an economic policy perspective concludes that a weak corporate governance framework will severely hinder all stages of the investment process and, thus, the overall prospects of the economy to build a strong private sector base for economic growth [33]. Consequently, it will impair the capacity to mobilise savings, hinder the efficient allocation of financial resources and prevent the proper monitoring of corporate assets.

2.4 Review of empirical studies

In the empirical literature, a limited number of works are considered that analyse the impact of a set of corporate governance standards on the financial performance of firms. While most works consider the impact of governance characteristics on financial performance, this paper will focus more on the impact of governance standards or practices on firms' financial performance. Patel and Dallas [34], in their study of American companies, examine the role of transparency and the disclosure of the information using an index consisting of 98 questions grouped into three categories: ownership structure and investor rights, financial transparency and disclosure and board and management structure and processes. Based on the results, they find that firms with a high index rate have a lower market risk and higher price-to-book value, so companies should improve disclosure and transparency to reduce the cost of capital [35]. La Porta et al. [36] have investigated differences in governance standards using a sample of 371 large firms from 27 countries with rich economies. Governance standards are presented through the legal protection of minority shareholders and the ownership of cash flow by a controlling shareholder, which have influenced the valuation of firms. Their data test shows that firms incorporated in countries with better governance standards (better protection of minority shareholders and weaker evidence of the benefits of higher cash flow ownership by controlling shareholders) tend to have a higher rating. Beiner et al. [37] have developed a corporate governance index and analysed the impact of different corporate governance mechanisms on the value of firms in Switzerland as measured by Tobin's Q. Some of the governance mechanisms utilised include the shares of the largest shareholder, outside block holdings, leverage, board size and the share of outside directors on the board. Based on the results, they find a positive and significant correlation between corporate governance and Tobin's Q. Chauhan et al. [38] have explored the effect of firm-level corporate governance practices on the financial performance of 84 publicly traded Indian firms for the period 2003–2013, focusing on founder ownership. Comprehensive corporate governance practices measured through the governance index (which includes boards of directors, audit committees, remuneration committees, general meetings and disclosure of financial information) have a positive relationship with the financial performance of these firms, as measured by the return on assets (ROA), Tobin's Q and firm size. This relationship becomes stronger when founder ownership is high. Monda and Giorgino [39] have designed a multidimensional index to measure the quality of corporate governance systems adopted by firms and use it to investigate the correlation between the quality of corporate governance and firm value. This complex index (CGI) comprises 39 variables referred to four dimensions: board, remuneration, shareholder rights and disclosure. To assess the

data, they applied the panel and ordinary least squares (OLS) models and fixed- and random-effects models. They have analysed a sample of 100 large companies listed on the main stock markets in five different countries (France, Italy, Japan, the United Kingdom and the USA) for three years (2009–2011), and based on the results, confirm the widespread hypothesis of the existence of a positive and statistically significant relationship between corporate governance, evaluated by a subset of 12 variables, and firm value, measured by Tobin's Q.

3. RESEARCH METHODOLOGY

This study aimed to identify the importance of corporate governance in financial performance, so we used qualitative and quantitative methods to achieve this objective. Both primary and secondary data were utilised in this research, dating from 2017 to 2021, and seven Western Balkan countries were considered. The quantitative data are macroeconomic indicators, which were obtained from the International Monetary Fund, then from the World Development Indicators (WDI), a database developed by the World Bank, and from the statistical reports of the authoritative institutions of the Western Balkans countries. Other resources include case studies in this field from confidential sources or published papers, analyses of foreign literature findings, research and existing materials, books, magazines and official documents. As for the econometric analysis, to evaluate and test the secondary data, the OLS method or multifactorial linear regression analysis, panel regression, fixed-effects regression, random-effects regression, linear trend analysis, correlation analysis, etc., were employed, which helped to determine the relative statistical importance of each independent (explanatory) variable in the influence of the dependent variable. All these econometric analyses and tests were carried out with the help of SPSS, Stata and Excel software, which provided the analysis and interpretation of the results in a detailed form.

Study Variables: To test the hypotheses, two models were used. In the first model, financial performance was measured through the return on equity (ROE) indicator, where the independent variables were financial leverage, liquidity, the index of financial disclosures, and total assets. In the second model, financial performance was assessed through the ROA indicator, while the independent variables were the same as in the first model. The description of variables included in the econometric models are presented in Table 1.

The regression equation for model I is specified in this form:

$$\begin{aligned} Y_{(ROE)} = & \beta_0 + \beta_1 X_1 (\text{Financial Leverage}) \\ & + \beta_2 X_2 (\text{Liquidity}) \\ & + \beta_3 X_3 (\text{Financial Disclosure index}) \\ & + \beta_4 X_4 (\text{Total Assets}) + \varepsilon \end{aligned} \quad (1)$$

The regression equation for model II is specified in this form:

$$\begin{aligned} Y_{(ROA)} = & \beta_0 + \beta_1 X_1 (\text{Financial Leverage}) \\ & + \beta_2 X_2 (\text{Liquidity}) \\ & + \beta_3 X_3 (\text{Financial Disclosure Index}) \\ & + \beta_4 X_4 (\text{Total Assets}) + \varepsilon \end{aligned} \quad (2)$$

Table 1. Description of variables included in econometric models

Variables	Variable Review	Calculation	Source
Dependent variable	Return on assets (ROA)	Net income/total assets ratio	IMF Annual Database (2017–2021)
Dependent variable	Return on equity (ROE)	Net income/total equity ratio	IMF Annual Database (2017–2021)
Independent variable	Financial leverage	Total liabilities/total assets ratio	IMF Annual Database (2017–2021)
Independent variable	Liquidity	Short-term assets/short-term liabilities Ratio	IMF Annual Database (2017–2021)
Independent variable	Index of financial disclosures	Includes categories: disclosure and transparency, shareholder rights and ownership structure, board responsibilities and composition, the role of stakeholders	World Bank WDI Annual Database (2017–2021)
Independent variable	Firm size	Natural logarithm of total assets	IMF Annual Database (2017–2021)

Source: Data processed by authors (2023)

The research question in relation to the first multifactorial model and the hypotheses of this paper are constructed as follows:

How does financial leverage, liquidity, total assets and the index of financial disclosures affect the ROE of the seven countries of the Western Balkans?

H0: Financial leverage, liquidity, total assets and the index of financial disclosures do not affect the ROE of the seven countries of the Western Balkans.

H1 (a): Financial leverage affects the ROE of Western Balkan countries.

H1 (b): Liquidity affects the ROE of Western Balkan countries.

H1 (c): The total assets affect the ROE of Western Balkan countries.

H1 (d): The index of financial disclosures affects the ROE of Western Balkan countries.

4. DATA ANALYSIS AND RESULTS

Results of the first multifactorial model – return on equity (ROE) are shown in Table 2.

Table 2. Descriptive statistics of the model

		Y1-ROE	Valid N (Listwise)
Descriptive Statistics	N	Statistic	35
	Range	Statistic	15.7
	Minimum	Statistic	3.7
	Maximum	Statistic	19.4
	Mean	Statistic	10.8877
	Std. Deviation	Statistic	4.00764
	Variance	Statistic	16.061
		Statistic	0.282
	Skewness	Std. error	0.398
		Statistic	-0.52
	Kurtosis	Std. error	0.778

Source: Authors' calculations in SPSS (2023)

Skewness and Kurtosis Coefficient

Coefficient of Curvature (Skewness) = Statistic/Std. Error = 0.282/0.396 = 0.708 (-1.96...+1.96). The results imply that these data are within the standard deviation - 1.96 to + 1.96, which means that the curve has a normal distribution.

Coefficient of Kurtosis = Statistic/Std. Error = - 0.520/0.778 = - 0.668. Based on the results, it is implied that these data are within the range of -1.96 to + 1.96, and since the value is negative, the curve is more depressed.

The linear regression equation for this regression model is:

$$YI_{(ROE)} = 2.573 + 0.574 + 0.018 - 0.512 + 1.250 + \epsilon$$

P-value < 0.05 » H0 x, H1 ✓ / P-value > 0.05 » H0 ✓, H1 x.
X1 (0.074 < 0.10) » H0 x, H1(a) ✓ – Based on the significance results, H0 is rejected, and HA is accepted because the significance value for X1 is less than a P-value of 0.10.

X2 (0.884 > 0.05) » H0 ✓, H1(b) x – Based on the significance results, H0 is accepted and HA is rejected.

X3 (0.225 > 0.05) » H0 ✓, H1(c) x – Based on the significance results, H0 is accepted and HA is rejected.

X4 (0.010 < 0.05) » H0 x, H1(d) ✓ – Based on the significance results, H0 is rejected, and HA is accepted because the significance value for X4 is less than a P-value of 0.10.

Based on the generated results of the coefficients, financial leverage (at the 10% significant level) and the disclosure index (at the 5% level) are the only variables that have influenced the ROE. If financial leverage and the index increase, this will also affect the rise in ROE (Table 3).

Coefficient of Correlation and Determination, their interpretation (Table 4):

➤ The correlation coefficient value is 66.8%, which shows that the variables YROE, X1-financial leverage, X2-liquidity, X3-total assets and X4 index of financial disclosures have an average positive relationship.

➤ The value of the *coefficient of determination* is 44.6%, which shows that YROE has an average level of dependence on X1-financial leverage, X2-liquidity, X3-total assets and X4 index of financial disclosures. So, for the value of 44.6%, financial leverage, liquidity, total assets, and disclosure index explain the ROE.

Based on Table 5, we can conclude that the value of the Pearson correlation coefficient for the dependent variable YROE and the independent variable X1 financial leverage is 0.074, indicating a very weak positive relationship. For the second variable, on X2, liquidity is -0.333, which demonstrates that there is a very weak negative relationship, while on X3, total assets is 0.051, which also shows that there is a very weak positive relationship, and on X4, the disclosure index is 0.538, which reveals that there is an average positive relationship.

Table 3. Coefficients

Coefficients ^a									
Model	Unstandardised coefficients		Standardised coefficients	t	Sig.	95.0% Confidence interval for B		Collinearity statistics	
	B	Std. Error	Beta			lower bound	Upper bound	Tolerance	VIF
(Constant)	2.573	7.047		.365	.720	-12.366	17.512		
1 Leverage/Tier 1 capital to assets	.574	.300	.415	1.915	.074	-.061	1.209	.738	1.354
Liquidity	.018	.119	.037	.149	.884	-.235	.271	.566	1.767
LnX3	-.512	.406	-.327	-1.262	.225	-1.373	.349	.514	1.944
disclosure index	1.250	.427	.825	2.927	.010	.345	2.155	.436	2.294

a. Dependent variable: Y1-ROE
Source: Authors' calculations in SPSS (2023)

Table 4. Model Summary

Model Summary ^b					
Model	R	R Square	Adjusted R square	Std. error of the estimate	Durbin-Watson
1	.668 ^a	.446	.307	3.13795	1.018

a. Predictors: (Constant), disclosure index, leverage/tier 1 capital to assets, liquidity, LnX3
b. Dependent variable: Y1-ROE
Source: Authors' calculations in SPSS (2023)

Table 5. Correlations

Correlations							
		Y1-ROE	Leverage /Tier 1 capital to assets	Liquidity	LnX3	Disclosure index	
Pearson correlation	Y1-ROE	1.000	.074	-.333	.051	.538	
	Leverage /Tier 1 capital to assets	.074	1.000	.133	.142	-.362	
	Liquidity	-.333	.133	1.000	.321	-.387	
	LnX3	.051	.142	.321	1.000	.373	
	Disclosure index	.538	-.362	-.387	.373	1.000	
Sig. (1-tailed)	Y1-ROE	.	.374	.070	.413	.006	
	Leverage/Tier 1 capital to assets	.374	.	.283	.270	.053	
	Liquidity	.070	.283	.	.078	.041	
	LnX3	.413	.270	.078	.	.048	
N	disclosure index	.006	.053	.041	.048	.	
	Y1-ROE	21	21	21	21	21	
	Leverage/Tier 1 capital to assets	21	21	21	21	21	
	Liquidity	21	21	21	21	21	
	LnX3	21	21	21	21	21	
	disclosure index	21	21	21	21	21	

Source: Authors' calculations in SPSS (2023)

Table 6. Analysis of variance (ANOVA)

ANOVA					
Model	Sum of squares	df	Mean square	F	Sig.
1 Regression	126.743	4	31.686	3.218	.041 ^b
Residual	157.548	16	9.847		
Total	284.291	20			

a. Dependent variable: Y1-ROE

b. Predictors: (Constant), disclosure index, leverage/tier 1 capital to assets, liquidity, LnX3

Source: Authors' calculations in SPSS (2023)

Based on the overall significance of the analysis of variance (ANOVA) (Table 6), we conclude that the entire model has accuracy since the significance value is less than 0.05. P-value (0.041 < 0.05).

The fixed-effects model, in this case, would be:

$$Y_{it} = 47.860 + 30.592D_{1i} + 3.499D_{2i} - 7.425D_{3i} + 22.871D_{4i} + 21.343D_{5i} + 2.349X_{1t} + 1.401X_{2t} - 0.031X_{3t} + 0.085X_{4t} - 5.391it$$

$$e = 100\% - R^2 = 100\% - 93.5\% = 6.5\% = 0.065it$$

where:

D1 – Albania, D2 – Bosnia and Herzegovina, D3 – Montenegro, D4 – North Macedonia, D5 – Serbia and D6 – Croatia, and as a reference state, we have taken Kosovo, with which these six states will be compared. More specifically, we aim to see if there is a difference between the ROE of the six states and Kosovo (Table 7).

α_0 – The average value of ROE in Kosovo is 47.860% (P-value = 0.323 > 0.05).

α_1 – This regression coefficient represents the ROE difference between Albania and Kosovo. In Albania, ROE will increase by 30.592% compared to ROE in Kosovo. The average value of ROE in Albania is 47.860% + 30.592% = 78.452% (P-value = 0.411 > 0.05).

α_2 – This coefficient represents the difference between Bosnia and Herzegovina and Kosovo. In Bosnia and Herzegovina, ROE will increase by 3.499% compared to ROE in Kosovo. The average value of ROE in Bosnia and Herzegovina is 47.860% + 3.499% = 51.359% (P-value = 0.818 > 0.05).

α_3 – The regression coefficient between Montenegro and Kosovo. In Montenegro, ROE will decrease by 7.425% compared to ROE in Kosovo. The average value of ROE in

Montenegro is 47.860% - 7.425% = 40.435%. (P-value = 0.034 < 0.05).

α4 – This regression coefficient represents the difference in ROE between North Macedonia and Kosovo. In North Macedonia, ROE will increase by 22.871% compared to ROE in Kosovo. The average value of ROE in North Macedonia is 47.860 + 22.871% = 70.731%. (P-value = 0.440 > 0.05).

α5 – The difference between Serbia and Kosovo. In Serbia, ROE will increase by 21.343% compared to ROE in Kosovo. The average value of ROE in Serbia is 47.860 + 21.343% =

69.203%. (P-value = 0.576 > 0.05).

α6 – The difference between Croatia and Kosovo. In Croatia, ROE will increase by 2.349% compared to roe in Kosovo. The average ROE value in Croatia is 47.860 + 2.349% = 50.209%. (P-value = 0.901 > 0.05).

α7 – This regression coefficient represents the predicted value of ROE when financial leverage increases by 1%. This statement is correct because the level of significance is within the confidence interval (P-value = 0.054 < 0.10).

Table 7. Coefficients

Panel Model – Fixed Effects – Return on Equity – Empirical Results									
Model	Unstandardised coefficients		Standardised coefficients Beta	t	Sig.	95.0% Confidence interval for B		Collinearity statistics	
	B	Std. error				Lower bound	Upper bound	Tolerance	VIF
(Constant – Kosovo)	47.860	46.025		1.040	.323	-54.690	150.410		
Albania	30.592	35.660	2.909	.858	.411	-48.863	110.048	.001	1773.039
Bosnia and Herzegovina	3.499	14.830	.333	.236	.818	-29.544	36.542	.003	306.639
Montenegro	-7.425	3.020	-.706	2.459	.034	-14.155	-.696	.079	12.718
1 North Macedonia	22.871	28.446	2.175	.804	.440	-40.512	86.253	.001	1128.248
Serbia	21.343	37.060	2.030	.576	.577	-61.232	103.917	.001	1914.961
Croatia	2.349	18.322	.223	.128	.901	-38.476	43.174	.002	468.074
Leverage/Tier 1 capital to assets	1.401	.641	1.013	2.184	.054	-.028	2.830	.030	33.150
Liquidity	-.031	.096	-.065	-.326	.751	-.245	.182	.164	6.085
Disclosure index	.085	.680	.056	.125	.903	-1.431	1.601	.032	31.083
LnX3	-5.391	6.124	-3.445	-.880	.399	-19.037	8.254	.000	2360.382

a. Dependent variable: Y1-ROE

Source: Authors' calculations in SPSS (2023)

Table 8. Empirical econometric model results

Variables	Linear Regression	Random Effects	Fixed Effects
ROE	.5744	.7306	1.4071
Financial leverage	(0.073) *	(0.120)	(0.053) **
Liquidity	.0179 (0.882)	-.0652 (0.484)	-.0310 (0.752)
Index of financial disclosures	1.2508 (0.010) **	.0882 (0.847)	.0909 (0.896)
Natural logarithm of total assets	-.5136 (0.224)	-.1213 (0.874)	-5.4094 (0.393)
_const	2.5631 (0.721)	7.4327 (0.470)	58.4073 (0.385)
R square	0.4462	0.2775	0.4153

Source: Authors' calculations in SPSS (2023)

Based on the results generated by the Stata program, in which the data have been subjected to three econometric analyses, including linear regression, as well as regression with random and fixed effects, we can conclude that from all the variables selected to analyse their effect on the ROE, financial leverage is significant in two of the three selected analyses with 5% and 10% significance. This shows that the debt/equity ratio is crucial to a firm's financial performance. This result is also in line with the findings of Kiprotich [40] (Table 8).

The Second Econometric Model

In the following section, we will present the results obtained using the SPSS program for our second econometric model, where the dependent variable this time is the ROA.

Based on the overall significance of the ANOVA (Table 9), we conclude that the whole model has no accuracy since the significance value is greater than 0.05 (P-value 0.113 > 0.05).

Table 9. ANOVA

ANOVA ^a					
Model	Sum of squares	df	Mean square	F	Sig.
1 Regression	1.955	4	.489	2.217	.113 ^b
Residual	3.527	16	.220		
Total	5.482	20			

a. Dependent variable: Y2-ROA

b. Predictors: (Constant), disclosure index, leverage/tier 1 capital to assets, Liquidity, LnX3

Source: Authors' calculations in SPSS (2023)

The regression equation for model II is specified in this form:

$$Y(ROA) = \beta_0 + \beta_1 X_1 (\text{Financial Leverage}) + \beta_2 X_2 (\text{Liquidity}) + \beta_3 X_3 (\text{Financial Disclosure Index}) + \beta_4 X_4 (\text{Total Assets}) + \varepsilon \quad (3)$$

Table 10. Coefficients

Coefficients ^a					
Model	Unstandardised Coefficients		Standardised Coefficients Beta	t	Sig.
	B	Std. Error			
(Constant)	.220	1.054		.209	.837
1 Leverage/Tier 1 capital to assets	.127	.045	.659	2.823	.012
Liquidity	-.001	.018	-.016	-.059	.954
LnX3	-.042	.061	-.191	-.684	.504
disclosure index	.089	.064	.425	1.399	.181

a. Dependent variable: Y2-ROA

Source: Authors' calculations in SPSS (2023)

Based on the generated results of the coefficients table, we see only that the financial leverage is a significant variable, where the increase in the leverage would also raise the ROA for the countries of the Western Balkans (Table 10).

5. CONCLUSIONS

This study evaluates the impact of corporate governance on the financial performance of seven Western Balkan countries, considering a total of six variables for an analysed period of five years. The leverage structure varies between the countries, with each one choosing that combination of debt to equity that not only reduces its capital costs but also maximises the company's value. A positive relationship has been found between financial leverage and ROE, where financial leverage tends to have a high impact on financial performance. As one of the most important decisions of corporate governance, there is still no single level that can be applied to all structures, whether the smallest enterprises or those that have weight at the state level. According to Kiprotich, it is not known if a smaller or larger ratio can positively or negatively affect performance. Even in our paper, while for Albania, a lower level of leverage tends to enlarge the ROA, the opposite happens in the state of Croatia, with high levels of debt to capital raising the ROA. Another significant and more important variable for our work is the index of financial disclosures, which has a significance of 0.010. This shows that high transparency and accuracy in financial reporting improve financial performance. Barth and Schipper argue that "transparency" is the extent to which financial reports reveal how corporate managers carry out their responsibilities in a way that is easily understandable to users of financial reports, and this affects the ROE, in our case, by increasing it. The positive ratio between these two variables shows us that as transparency increases, there is a tendency for financial performance to become better as well. It is worth noting that this study had limitations regarding data collection, especially for the index of disclosures. For the last two years, there has been a lack of data for all the countries analysed due to the prevalence of the pandemic during those years, which has caused this index not to be measured due to an absence of information. The other variables examined did not have a significant weight in the investigation. This research could be extended to cover longer periods and larger sample sizes. In addition, future researchers could also investigate other factors that affect corporate governance in terms of different econometric models.

Furthermore, the scope could be further improved using other evaluation models. Based on the results, we recommend that the countries included in the analysis, as well as other nations as a whole, should improve financial reporting practices by being as transparent and accurate as possible in the publication of financial reports to generate better financial performance, but also create greater security for investors and stakeholders. This is best proven by the state of North Macedonia, which had the highest financial disclosure index compared to the other states included in the analysis. As a result, the ROE and ROA were higher. We also recommend that the governing boards should not be afraid when they use a high degree of debt in their financing because a high degree of financial leverage does not necessarily mean a negative result. It may even have the opposite outcome, as is the case with the states of Serbia and Croatia, where even though they

have used high degrees of financial leverage against their capital, this has not affected their lower ROA or capital in any way. Finally, based on the results of the panel model, where we compared the state of Kosovo with other states of the Western Balkans, we see that there is a negative relationship between Kosovo and Montenegro. This negative relationship can serve as information for further papers to analyse how countries that are correlated with each other can influence one another.

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