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The Impact of Corporate Governance on Financial Performance: An Analysis of Small-Cap Companies Listed on the Hong Kong Stock Exchange

by
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Abstract

This paper examines the impact of selected corporate governance mechanisms on the financial performance of small-cap firms listed on the Hong Kong Stock Exchange. Small-cap firms face different realities than large companies in terms of financial constraints, concentrated ownership, and heavy compliance demands. As related to the above, this study focuses on three chosen mechanisms, namely: board independence, Chair/CEO duality, and audit committee activity. A mixed-methods research methodology was adopted for this study. The quantitative component involved a simple regression analysis on a sample of 100 firms spanning from 2018 to 2023. Financial metrics of return on assets (ROA) and return on equity (ROE) were used as financial performance measures. The qualitative approach adopted semi-structured interviews with 14 directors and governance professionals. The transcripts were analyzed using phenomenological techniques to capture lived experience of the participants. The empirical results show that higher board independence has little and, at times, a negative impact on financial performance, suggesting inefficiency and a largely symbolic role on the part of independent directors. When the Chair and CEO roles are combined, both ROA and ROE decline, highlighting the risks of concentrated authority. More frequent audit committee meetings do not by themselves lead to better results, rather it is the quality of the meetings that matter more. Participants' responses echo a similar conclusion in that box-ticking compliance and limited resources are the persistent hurdles.

Keywords - corporate governance, small-cap companies, board independence, Chair/CEO Duality, audit committee activities, financial performance, return on assets, return on equity, Hong Kong Stock Exchange, resource constraints.

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Introduction and Background of the Study

The Hong Kong Stock Exchange (HKEX) is one of the largest stock exchanges in the world. It has a market capitalization of about US$3.4 trillion with 2,604 companies listed as of February 2025. Large-cap firms accounted for 68.2% of the total, and the small-cap firms accounted for US$1.1 trillion, or 31.8%.

Hong Kong's Corporate Governance Code was first introduced in 2005 and has been updated in 2012, 2016, 2018, 2022, and 2024 for a total of six times. The Hong Kong's Corporate Governance Code applies to all companies listed on HKEX but its effect on small-cap firms has not been studied and its effectiveness remains uncertain. Many small-cap firms lack the resources and specialized expertise needed to build strong corporate governance mechanisms. Prior research (Filatotchev & Nakajima, 2014) shows that smaller firms often struggle to comply with the code and/or listing rules because of structural and financial constraints. As a result, policymakers, investors, and other stakeholders are uncertain whether the code together with the reforms are appropriate or effective for this market segment.

This study fills this gap by examining whether board independence, Chair/CEO duality, and audit committee activity have an impact on the financial performance of HKEX-listed small-caps. By mapping these relationships, this study aims to offer insight into tailored governance approaches and to improve investor confidence as related to this market segment. While substantial research has explored the relationship between corporate governance mechanisms and financial performance in large-cap companies globally (Bhagat & Bolton, 2007), there are limited studies on the small-cap market segment, and in particular to the Hong Kong market, and to a greater extent, size-specific governance studies on Asian markets (Claessens & Yurtoglu, 2013). Research that provides insight by linking corporate governance mechanisms to financial performance is thus obviously beneficial to regulators and investors.

In addition to the above, there have been limited qualitative studies that leverage the lived experience of the director with respect to corporate governance as highlighted in Ng, S. C. J. (2018), let alone research that provides insight into the relationship between corporate governance mechanisms and financial performance. The qualitative input of this study will therefore provide useful insight into the relationship. The findings can fill the literature gap, informing regulators on the effectiveness of current practices, which can ultimately benefit small-cap firms specifically needed to improve their financial sustainability and the broader financial ecosystem.

Although many studies have been done on the larger-cap companies, not much has been done on the small-cap firms. The Hong Kong Corporate Governance Code ("CG Code") has been revised and updated six times, since it was introduced. The revisions made often reflect the priorities of respondents of large-cap companies and their institutional investors while small- and mid-cap companies frequently raised concerns about costs, resource constraints, and implementation challenges. The actual effect of these revisions upon smaller entities remains unclear. The effectiveness of the code in enhancing the financial performance of small-cap firms also remains uncertain. Lack of effectiveness and uncertainty may result in regulators setting rules without sufficient knowledge; investors misjudging risks; and management adopting governance structures that are not suitable for their scale.

Moreover, substantial research has been done to explore the relationship between corporate governance practices and financial performance in large-cap companies globally. At the same time, there are limited empirical studies on small-cap companies, especially those listed in HKEX, one of the largest worldwide exchanges. Size-specific governance research in Asian markets linking quantitative evidence of governance practices to financial outcomes can prove therefore to be beneficial to regulators and policymakers in this regard.

This study thus intends to address this gap by analyzing the relationship of the selected corporate governance mechanisms and the financial performance of HKEX-listed small-cap companies. The goal is to offer practical guidance that strengthens corporate governance mechanisms and which support sustainable growth and enhance investor confidence.

The approach of this study focuses upon selected board independence, chair/CEO duality, and audit committee activities as the components of corporate governance mechanisms that are needed to understand whether they will influence firm financial performance. These mechanisms are supported by agency theory and stewardship theory, which emphasize reducing conflicts of interest between management and shareholders, and resource dependence theory, which highlights the value of expertise and oversight in governance.

Research questions and hypotheses

This study focuses upon the core issue of "How do specific corporate governance practices namely independent boards, Chair/CEO duality roles, and audit committee activities impact the financial performance of Hong Kong's small-cap listed companies, specifically with respect to their Return on Assets ROA and Return on Equity ROE?"

In addition to the main question above, the research proposed in this study tries to answer three more in-depth sub-questions:

a. Do boards with more independent directors lead to better financial decisions for small-cap firms and which result in better financial performance?
b. Do individuals who hold both the Chair and CEO positions in simultaneity enhance efficiency, or will they introduce potential blind spots for small-cap

listed companies?

c. Will audit committees that convene more frequent meetings effectively identify financial issues before they escalate, or do excessive inspections hinder innovation and/or performance?

The following are the independent and dependent variables identified in this study**:**
Independent Variables

a. Board independence
Board independence is characterized by the inclusion of directors who are not involved in the company's day-to-day operations and who do not have any significant connections with the company that could compromise their ability to make impartial decisions. It is measured by the proportion of independent directors on the board.
b. Chair/Chief Executive Officer Duality
Chair/Chief Executive Officer (CEO) duality refers to the corporate governance practice wherein the same individual holds the roles of the Chair of the Board of Directors and the Chief Executive Officer (CEO). It results in a consolidation of power, which may compromise the board's capacity to adequately supervise management. It is a binary variable showing whether the roles of chairperson and CEO are held by the same individual (1 if duality exists, zero otherwise).
c. Audit Committee Activities
Audit committee activities refer to the various tasks and responsibilities undertaken by a company's audit committee needed to ensure the integrity of financial reporting, compliance with legal and regulatory requirements, and the effectiveness of internal control systems. To ensure the proper functioning of a company's audit committee, the HKEX requires that audit committee must be chaired by an independent non-executive director with the appropriate professional qualifications. The measurement of this independent variable is the frequency of audit committee meetings.

Dependent Variable

Dependent variable is financial performance. which is measured by financial metrics Return on Assets (ROA) and Return on Equity (ROE). Tantra et al. (2022) justify the use of ROA and ROE as financial performance metrics by highlighting their ability to measure profitability and efficiency. ROA measures the efficiency of a company needed to employ its assets profitably, while ROE gauges the returns generated for the shareholders.

Hypotheses

Aligned with the objective of research, the hypotheses are structured to examine the impact of corporate governance practices on the financial performance in small-cap firms listed on the HKEX. The hypotheses are as follows:

a. Board Independence

H1: There is a positive relationship between the proportion of independent directors on the board and the financial performance of small-cap companies listed on HKEX.

b. Chair/Chief Executive Duality

H2: There is a positive relationship between chair/CEO duality and the financial performance of small-cap companies listed on HKEX.

c. Audit Committee Activities

H3: There is a positive relationship between the frequency of audit committee meetings and the financial performance of small-cap companies listed on HKEX.

The study therefore investigates how the three chosen governance mechanisms influence financial performance. First, whether the proportion of independent directors on the board genuinely matters. Second, it tests whether combining the CEO and Chair roles into one person affects operational effectiveness and creates governance blind spots. Third, it examines frequency of audit committee meetings matter. At the same time, and as a limitation, the study does not take into consideration mechanisms such as board size, executive pay, or shareholder rights.

Financial performance is measured using financial metrics of ROA and ROE to reflect the firms' efficiency and profitability. Market-based financial performance indicators such as share price performance and earnings per share have been dropped as return may be complicated by market expectation. The sample is drawn from HKEX-listed small-cap firms, specifically, HSSI constituents with a market capitalization of US$1.28 billion or less. Mid- and large-cap companies are excluded.

The analysis covers a six-year period to reflect the recent trends and effects; data prior to 2018 were not considered. The theories applicable in the study are stewardship theory, agency theory, resource dependence theory and stakeholder theory. which link corporate governance mechanisms with financial results.

In addition to the limitations noted previously, there are additional limitations. The findings are based on the data of Hong Kong small-cap firms listed on HKEX and may not be generalizable to other markets or company sizes. The analysis relies on ROA and ROE; it does not use other financial indicators like valuation or stock returns. The study has not taken into consideration factors such as strategy, industry conditions, or macroeconomics, which could influence the results of this study. Lastly, this study is limited to three chosen corporate governance mechanisms, namely board independence, Chair/CEO duality, and audit committee activity. Other corporate governance mechanisms were not analyzed.

The positives of this study are that it leverages publicly listed companies, which have clear advantages over privately held firms. The advantages include public disclosures, timely audited financials announcement, and standardized data availability. In addition, the listed companies are held to a required level of corporate governance and compliance standards as required under the Hong Kong Corporate Governance Code, which makes them perfect to research on the effects of financial performance. Furthermore, the financial and corporate governance data are readily available from the sampled companies filed with the HKEX.

The following terms are therefore defined in this study:

a. Audit Committee Activities: Frequency of meetings to oversee financial reporting and compliance.
b. Board Independence: Proportion of independent non-executive directors with no material ties to the company
c. Chair/CEO Duality: A governance structure where the same individual holds both the Chair and CEO roles.
d. Corporate Governance: The system of rules, practices, and processes by which a company is directed and controlled (OECD, 2015).
e. Hong Kong Corporate Governance Code: refers to Appendix 15 of Listing rules of HKEX
f. Return on Assets (ROA): Profitability ratio measuring net income generated per dollar of assets.
g. Return on Equity (ROE): Efficiency ratio assessing pre-tax returns relative to equity.
h. Small-cap Company: A constituent share of company included in HSSI with a market capitalization of no more than US$1.28 billion.

Literature Review

Corporate governance is the system by which a company is directed and held accountable. When governance works, it brings shareholders and managers into alignment, lowers friction, and supports stronger performance (Shleifer & Vishny, 1997).

In Hong Kong, the HKEX introduced the Corporate Governance Code (CG Code) in 2005 and has strengthened over time to encourage greater independence, diversity, and more robust audit oversight. The Code applies to all listed companies on HKEX, its effectiveness on smaller companies has not been analyzed and, as mentioned, remains uncertain.

Much of the evidence to date comes from study of large firms (Bhagat & Bolton, 2007), leaving open the question of whether those results are applicable to Hong Kong's small-caps. Smaller companies often operate with limited resources and concentrated ownership, conditions that can weaken governance (Filatotchev & Nakajima, 2014). This chapter discusses the theoretical foundations and the literatures needed to identify the gaps in current knowledge; it also sets the stage for the analysis that follows.

Theoretical foundations

Specifically, this study has a theoretical foundation based on Agency theory, Stakeholder theory, Stewardship theory, and Resource dependence theory.

Agency theory

Under agency theory, owners and managers often have different goals (Jensen & Meckling, 1976). Corporate governance helps close this gap through effective oversight and performance-linked incentives (Shleifer & Vishny, 1997). Specifically, it explains how the chosen mechanisms are relevant to financial performance. For example, with board independence, independent directors can question weak decisions and spending, which supports better ROA and, by extension, ROE. With Chair/CEO duality, combining the two roles can weaken oversight,and undermine operational effectiveness which will affect financial performance.

Finally, under audit committee activity, a capable, independent audit committee enhances reporting quality and risk management, identifying financial issues early and thus leads to a more reliable ROA and ROE.

Stakeholder theory

Under stakeholder theory, boards should consider the interests of shareholders, creditors, employees, and the broader community (Freeman, 1984). The theory suggests that transparent reporting and credible oversight reduce conflicts and financing costs and consequently improve financial performance. Audit committees help ensure that financial disclosures are accurate, consistent, and credible.

Stewardship theory

With stewardship theory, managers are often motivated to build long-term value (Donaldson & Davis, 1991). In some situations, combining the Chair and CEO roles can speed coordination and decision-making, especially when time is of the essence. It offers a counterpoint to agency theory's emphasis on role separation.

Resource dependence theory

Under resource dependence theory, boards bring external resources such as expertise, networks, and access to capital (Pfeffer & Salancik, 1978). With board independence, directors with relevant expertise and networks can lower execution risk and improve access to financing which supports ROA and ROE. With audit committee activity, reliable, well-evidenced oversight increases confidence among auditors and investors, which will reduce the cost of financing, and reinforces financial discipline.

With mechanisms and expected effects, and with board independence, it is typically correlated with stronger ROA and ROE by improving oversight and opening access to external resources, though the contribution is often smaller in tightly controlled family firms. With chair/CEO duality, it is usually a drawback since it weakens checks and balances. It can be neutral or occasionally helpful in fast-moving circumstances and/or crisis. Finally, with audit committee activity, it tends to help by increasing an emphasis on reporting quality and tightening risk control. The payoff varies based upon the circumstance of ownership concentration as well as the independence and the skillfulness of the committee.

Board independence

Research and study results into mature markets and with respect board independence generally found a higher proportion of independent directors yielding better valuations and profitability (Dalton et al., 1998; Fernández-Temprano & Tejerina-Gaite, 2020; Klein, 2002; Pucheta-Martínez & Gallego-Álvarez, 2020). Those findings mostly reflect large, widely held firms. In Hong Kong's small-caps sector, many of which are family-controlled, the independent directors often have limited leverage over agendas and information (Ng, 2018). In principle, greater independence should raise financial performance via tighter monitoring and broader expertise. In practice, when a dominant owner controls agendas and information, independent directors' contribution to financial performance will be muted.

Chair/CEO duality

With respect to Chair/CEO duality, keeping the Chair and CEO roles separated tends to improve oversight and curb agency costs (Brickley, Coles, & Jarrell, 1997; Sun, 2023). However, during a liquidity squeeze, a sharp market shock, or a complex transaction, combining the roles on one person can help when a company moves quickly and speaks with one voice (Boyd, 1995; Lam, 2012). On average, duality weighs on financial performance. In high-pressure circumstances, the coordination premium can offset the discount.

Audit committee activities

Additionally, strong audit committees will ensure reporting credibility and will help boost investor confidence. Greater independence and activity backed by accounting expertise are associated with clearer disclosures, less earnings management and stronger performance (Alawaqleh & Almasri, 2021; Dakhlallh et al., 2020; Shatnawi et al., 2021). Nonetheless impact is not uniform. It strengthens financial performance when ownership is supportive of genuine oversight and when the committee has the mandate and skills to challenge management (Al Farooque et al., 2020). Evidence of specific resource-constrained small-caps is weaker, although the expected link to financial performance is positive. It is a question of who controls the firm and the committee's quality.

Synthesis of findings

Hong Kong small-cap companies are typically tightly held, family-influenced, and resource-strained. Formal governance often has limited traction (Almashhadani et al., 2022; Li et al., 2024; Ng, 2018). Board independence and active audit committees should support positive financial performance but the effect weakens when controlling shareholders gatekeep information or when committees lack real independence or financial expertise. Chair/CEO duality is generally negative for financial performance because checks and balances erode. On the contrary, a single voice during crisis can speed decisions and sometimes offset the downside, thus being consistent with stewardship arguments.

Methodology

This study employs both quantitative and qualitative method in the assessment of the impact of corporate governance mechanisms like board independence, chair/CEO duality, and audit committee activity on financial performance of HKEX listed small-cap companies. Quantitative analysis complements with qualitative evidence of participants lived expertise offering insight beyond empirical conclusion. Sample is drawn from the Hang Seng Composite SmallCap Index (HSSI). As of 28 February 2025, HSSI has 210 constituent shares. The study applied a USD 1.28 billion market-cap ceiling to focus on the index's lower tier companies yielding 163 firms. It covers all the 12 sectors ranging from energy to consumer discretionary, thereby preserving cross-industry variation. To enhance panel stability and limit turnover bias, only firms that remained in the HSSI for the entire six-year period between 2018 to 2023. were retained; a final sample of 100 companies was produced.

Quantitative analysis

Consistent with prior corporate governance research (Bhagat & Bolton, 2008; Gompers, Ishii, & Metrick, 2003), the impact of board independence, Chair/CEO duality, and audit committee activity relating to financial performance was analyzed. Using a balanced six-year panel for these 100 firms, associations controlling ownership concentration, firm size, leverage, and industry and year fixed effects were estimated. Robustness was assessed with clustered standard errors and alternative specifications, including varied size cutoffs, rolling HSSI membership, and selective sector exclusions. Data for this analysis were collected from the annual reports submitted by the target companies, which can be accessed on the HKEX website. Financial and governance reports filings are a dependable data source (Healy & Palepu 2001). Missing information were supplemented with data from Thomson Reuters Eikon and Bloomberg.

The target companies were the constituent shares of the Hang Seng Composite SmallCap Index, which represents small-cap firms in Hong Kong (Hang Seng Indexes Company Limited, 2023) each with a market capitalization below HKD 10 billion. The study covered a 6-year period (2018–2023), with 2023 being the latest year of data availability at the time of collection. This period enabled the documentation of changes and the observation of trends in governance practices and financial performance across these timeframes (Goodell, 2020; Shen, Fu, & Zheng, 2022).

Independent variables selected are as follows:

a. Board independence which is measured by the percentage of independent directors on the board.
b. CEO/Chair Duality is a binary variable that is either 1 or 0 depending on whether duality exists.
c. Activities of the Audit Committee are measured by meeting frequency and the inclusion of financial specialists on the committee will be neglected as the HKEX listing rule requires the audit committee to be chaired by a financial knowledgeable independent director such as a qualified accountant.

Dependent variables, which measure financial performance, are Return on equity (ROE) and return on assets (ROA). These ratios assess how efficiently a company uses its assets and equity to generate profits.

Sampling

The Hang Seng Composite Index Series ("HSCI Series") serves as a comprehensive benchmark for the general performance of the Hong Kong stock market (Hang Seng Indexes Company Limited, 2025). There are three size indexes under the Hang Seng Composite Size Indexes (HSCI): Hang Seng Composite LargeCap Index ("HSLI"), Hang Seng Composite MidCap Index ("HSMI"), and Hang Seng Composite SmallCap Index ("HSSI"). HSLI has market coverage of the top 80%, HSMI covers the next 15%, and the remaining 5% is allocated to HSSI (Hang Seng Indexes Company Limited, 2025). The sample is drawn from the Hang Seng Composite SmallCap Index (HSSI), which is the constituent shares of the smaller Hong Kong listed firms and which offer a useful insight into their corporate governance practices. As of February 28, 2025, the index consists of 210 constituent shares. To focus on the lower tier of the segment, a market-cap ceiling of US$1.28 billion is set, which thus reduced the total sample to 163 companies across 12 industries, from energy to consumer discretionary; this range reflects the breadth of the small-cap universe. For a stable panel and to limit turnover bias, this study then kept only firms that remained in the HSSI for six consecutive years, producing a final sample of 100.

Analysis techniques and tools

For the quantitative portions of this study, this study used panel data regression. This approach combines cross-sectional differences across firms with changes over time, allowing us to control for unobserved, time-invariant firm traits and common time shocks (Wooldridge, 2021; Baltagi, 2021). Panel data regression is a good fit for this topic because it lets researchers track the same firms over time while also comparing them with one another, helping to control for hard-to-observe differences that might otherwise bias the results (Gujarati & Porter, 2021).

Performance is gauged with Return on Assets (ROA) and Return on Equity (ROE), two standard measures of how efficient firms turn assets and equity into profits (Bhagat & Bolton, 2008; Gompers, Ishii, & Metrick, 2003). The governance variables of interest are board independence, whether the chair and CEO roles are combined, and the intensity of audit committee activity—factors often cited for their impact on outcomes (Yermack, 1996; Himmelberg, Hubbard, & Palia, 1999).

The general form of linear regression as the model for analysis was used.
Financial performance (ROA or ROE) = β0 + β1(Board independence) + β2(Chair/CEO duality) + β3(Audit committee activity) + ε,
where β0 is the intercept, β1 to β3 are the coefficients of the independent variables, and ε is the error term (Wooldridge, 2021; Gujarati & Porter, 2021).

As customary in corporate governance study, common controls such as firm size, leverage, and industry are included (Baltagi, 2021; Himmelberg et al., 1999).

Firm size: Bigger firms usually have more resources which will attract more outside scrutiny and benefit from scale. These will support stronger governance and better results. Smaller firms, especially those in the small-cap space, often operate with tighter budgets and lean teams which can limit what they can put in place (Demsetz & Lehn, 1985; Coles, Daniel, & Naveen, 2008; Guest, 2009). (Fama & Jensen, 1983; Klein, 2002; Chen, Li, & Shapiro, 2011).

Leverage: Debt is a double-edged sword whereby it can keep managers disciplined but it also raises financial risk and can hurt profitability and valuation if the level is too high. (Jensen & Meckling, 1976; Modigliani & Miller, 1958; Myers, 1977; Himmelberg et al., 1999).

Industry: Industries operating in different sectors will face different levels of competition and market regulation. Industry controls are essential so that sector patterns will not be mistaken for governance effects. (Gompers, Ishii, & Metrick, 2003; Leuz, Nanda, & Wysocki, 2003; Yermack, 1996).

With the introduction of control variables, the regression formula is modified as follows:

Financial Performance (ROA or ROE) = β0 + β1(Board Independence) + β2(Chair/CEO Duality) + β3(Audit Committee Activities) + β4(Size) + β5(Leverage) + β6(Industry) + ε.

The revised model will account for firm-specific, leverage specific and industry-specific influences when the relationship between corporate governance mechanisms and financial performance is examined

Qualitative Analysis

For the qualitative portions of this study, a phenomenological approach was adopted to interpret the lived experiences of the participants (Moustakas, 1994). This approach is designed for rich and reliable findings. The framework of this approach (Creswell & Poth, 2018) was set to view the issues through the participants' eyes and learnt from their personal experience. The phenomenological process is as follows:

- Bracketing: We set aside our own assumptions and focus on what participants would share with us (Finlay, 2002; Creswell & Poth, 2018).
- Data collection: We held in-depth interviews with semi-structured questionnaires to get to the center of each participant's experience.
- Phenomenological reduction: The interviews would be transcribed, coded and themes identified. During the interview, we listen carefully to the participants' sharing and made sense of their experiences (Patton, 2015; Charmaz, 2014).

As part of a phenomenological approach, phenomenological research emphasizes depth over breadth (Van Manen, 2016; Creswell & Poth, 2018; Moustakas, 1994). A small, focused sample is normally involved and considered appropriate. Purposive sampling was therefore employed to identify and recruit participants who had meaningful experience and insight for our questions. The data so obtained would align with the study's goals (Smith, Flowers, & Larkin, 2009). This allows researchers to learn from those with first-hand knowledge of corporate governance and relevant expertise (Palinkas et al., 2015; Patton, 2015). As Creswell and Poth (2018) noted that the goal of purposive sampling is to select individuals whose experiences fit the study.

The sampling plan for this study included the following:

- Clear inclusion criteria: Participants should have relevant professional qualifications and relevant experience of being director of small-cap board and a member of the audit committee, and/or professional practitioner of corporate governance.
- Targeted recruitment: Identification and recruitment of participants who are members of the professional bodies such as the Hong Kong Independent Non-Executive Directors Association, the Hong Kong Institute of Directors, and the Hong Kong Chartered Governance Institute.
- Limited reliance on familiarity: Although some of the invitees may be known to the researcher, selection is solely based on qualifications and suitability rather than convenience.

Analysis

For data collection and analysis, semi-structured in-depth interviews with 10–15 directors and/or governance specialists were conducted. This falls within the typical range for phenomenological studies of being 5–25 participants (Creswell, 1998; Morse, 2000). The aim is to collect rich, first-hand accounts prioritizing depth and meaning over numbers (Moustakas, 1994; van Manen, 2016). Interviews focused on themes such as board independence, chair/CEO duality, audit committee activity, and their perception of the relationship between the corporate governance mechanisms and financial performance.

Quantitative Analysis

This section presents and discusses the quantitative analysis results on the relationship between corporate governance and financial performance. The analysis consists of two parts:

1) Analysis of the six years period with 594 observations from 100 sampled companies.
2) Evaluation of hypothesis based on the regression results of the Ful Six-Year Analysis.

The following table highlights the key benchmarks, significant findings, and theoretical implications from the regression analyses of ROA and ROE.

Table 1

Regression significant findings

Metric	**ROA Analysis**	**ROE Analysis**
Time Period	2018–2023	2018–2023
Dependent Variable	Return on Assets (ROA)	Return on Equity (ROE)
Multiple R	0.542 (moderate positive)	0.511 (moderate positive)
R^2	0.294 (29.4% variance explained)	0.261 (26.10% variance explained)
Adjusted R^2	0.274	0.240
F-Statistic	14.72 ($p < 0.001$)	12.49 ($p < 0.001$)
Significant Predictors	Chair/CEO Duality: Significant negative ($\beta = -0.006$, $p = 0.0128$)	Chair/CEO Duality: Significant negative ($\beta = -0.019$, $p = 0.002$)
Non-Significant Predictors	Board Independence: Not significant ($p = 0.168$)	Board Independence: Marginally significant ($p = 0.084$)
	Audit Committee Activities: Not significant ($p = 0.364$)	Audit Committee Activities: Not significant ($p = 0.37$)

Source: A summary of regression results from Tables 2 and 3

Table 2

Regression Analysis of ROA for 2018-2023 with full 6 years Financials

Appendix 1 - Regression Analysis of ROA for 2018-2023 with full 6 years Financials						
Regression Statistics						
*Multiple R	0.5424					
*R Square	0.2942					
*Adjusted R Square	0.2742					
Standard Error	0.0690					
Observations	582					
ANOVA						
	df	*SS*	*MS*	**F*	*Significance F*	
Regression	16	1.1226	0.0702	14.7195	1.14E-33	
Residual	565	2.6931	0.0048			
Total	581	3.8157				
	**Coefficients*	*Standard Error*	*t Stat*	**P-value*	***Lower 95%*	****Upper 95%*
Intercept	0.0994	0.0872	1.1401	0.2547	-0.0718	0.2706
Board Independence	-0.0521	0.0377	-1.3804	0.1680	-0.1261	0.0220
Chair/CEO Duality	-0.0057	0.0023	-2.4965	0.0128	-0.0101	-0.0012
Audit Committee Activities	-0.0016	0.0018	-0.9077	0.3644	-0.0051	0.0019
Co Size	-0.0003	0.0029	-0.0985	0.9215	-0.0060	0.0054
Leverage	-0.0294	0.0039	-7.4757	0.0000	-0.0372	-0.0217
Industrials	-0.0038	0.0697	-0.0545	0.9565	-0.1407	0.1331
Financials	-0.0349	0.0706	-0.4947	0.6210	-0.1736	0.1038
Properties & Construction	-0.0086	0.0699	-0.1228	0.9023	-0.1460	0.1288
Information Technology	-0.0377	0.0698	-0.5407	0.5889	-0.1749	0.0994
Healthcare	-0.0201	0.0698	-0.2878	0.7736	-0.1573	0.1171
Energy	-0.0276	0.0721	-0.3832	0.7017	-0.1694	0.1141
Materials	-0.0189	0.0702	-0.2695	0.7877	-0.1567	0.1189
Telecommunications	-0.0169	0.0722	-0.2348	0.8145	-0.1587	0.1248
Utilities	-0.0082	0.0707	-0.1156	0.9080	-0.1470	0.1306
Conglomerates	-0.3449	0.0750	-4.5998	0.0000	-0.4922	-0.1976
consumer	-0.0103	0.0695	-0.1484	0.8821	-0.1469	0.1262

Source: Financial and Corporate Governance data extracted from annual reports of the sample companies

Table 3

Regression Analysis of ROE for 2018-2023 with full 6 years Financials

Appendix 2 - Regression Analysis of ROE for 2018-2023 with full 6 years Financials						
Regression Statistics						
*Multiple R	0.5424					
*R Square	0.2942					
*Adjusted R Square	0.2742					
Standard Error	0.0690					
Observations	582					
ANOVA						
	df	*SS*	*MS*	**F*	*Significance F*	
Regression	16	1.1226	0.0702	14.7195	1.14E-33	
Residual	565	2.6931	0.0048			
Total	581	3.8157				
	**Coefficients*	*Standard Error*	*t Stat*	**P-value*	***Lower 95%*	****Upper 95%*
Intercept	0.0994	0.0872	1.1401	0.2547	-0.0718	0.2706
Board Independence	-0.0521	0.0377	-1.3804	0.1680	-0.1261	0.0220
Chair/CEO Duality	-0.0057	0.0023	-2.4965	0.0128	-0.0101	-0.0012
Audit Committee Activities	-0.0016	0.0018	-0.9077	0.3644	-0.0051	0.0019
Co Size	-0.0003	0.0029	-0.0985	0.9215	-0.0060	0.0054
Leverage	-0.0294	0.0039	-7.4757	0.0000	-0.0372	-0.0217
Industrials	-0.0038	0.0697	-0.0545	0.9565	-0.1407	0.1331
Financials	-0.0349	0.0706	-0.4947	0.6210	-0.1736	0.1038
Properties & Construction	-0.0086	0.0699	-0.1228	0.9023	-0.1460	0.1288
Information Technology	-0.0377	0.0698	-0.5407	0.5889	-0.1749	0.0994
Healthcare	-0.0201	0.0698	-0.2878	0.7736	-0.1573	0.1171
Energy	-0.0276	0.0721	-0.3832	0.7017	-0.1694	0.1141
Materials	-0.0189	0.0702	-0.2695	0.7877	-0.1567	0.1189
Telecommunications	-0.0169	0.0722	-0.2348	0.8145	-0.1587	0.1248
Utilities	-0.0082	0.0707	-0.1156	0.9080	-0.1470	0.1306
Conglomerates	-0.3449	0.0750	-4.5998	0.0000	-0.4922	-0.1976
consumer	-0.0103	0.0695	-0.1484	0.8821	-0.1469	0.1262

Source: Financial and Corporate Governance data extracted from annual reports of the sample companies

Key results from Regression Analysis

Chair/CEO Duality shows a clear negative link with performance: ROA (β = −0.006, p = 0.0128) and ROE (β = −0.019, p = 0.002). This aligns with agency theory (Jensen & Meckling, 1976) and Brickley et al. (1997): when one person is both Chair and CEO, power gets concentrated and accountability slips. In short, splitting the roles tends to support better decisions and stronger results.

On the contrary, Board Independence and Audit Committee Activity were not statistically linked to financial performance with ROA (p = 0.168; p = 0.364) and ROE (p = 0.084; p = 0.37). It is not in line with many earlier studies (e.g., Dalton et al., 1998; Alawaqleh & Almasri, 2021).

In our analysis, separating the chair and CEO roles stands out as the clear reliable and impactful conclusion for better financial performance. However, in contrast, board independence and audit committee activity show weaker link to financial performance, which suggests that context matters. It depends on whether there are concentrated shareholding and ownership. It also depends on whether there are strict compliance rules and how they are enforced. All of these affect how corporate governance mechanisms influence financial performance.

Theoretical contributions

The empirical analysis results demonstrated a clear negative relationship between Chair/CEO duality and financial performance. It is in line with agency theory advocation (Jensen & Meckling, 1976). In plain terms, splitting these roles improves accountability and usually leads to better decisions and hence financial performance.

As for the relationship between board independence, audit committee activity and financial performance, it is statistically insignificant in our results indicating they are not universal fixes. Their impact is likely to change with ownership of the company; how strictly rules are enforced; and local business practices, especially in emerging markets where oversight can be lighter.

To conclude, there is no one best governance playbook. Companies and regulators should tailor their approach in accordance with their market conditions and how the business actually works in practice.

Evaluation of Hypotheses

The F-test verifies whether the independent variables, namely Board Independence, Chair/CEO Duality, and Audit Committee Activity explain financial performance (ROE and ROA). For ROE, the F-test returned a p-value of 1.93 × 10^-28 (well below 0.05). In plain terms, taking together, these governance variables explain a meaningful share of the variation in ROE. This confirms that the model is statistically significant. Similarly, for ROA, the F-Test produced a significance F (p-value) of 1.1389E-33 ($p < 0.05$). This result demonstrates that the independent variables also explain a significant portion of the variation in ROA. Therefore, the model is statistically significant for both measures of financial performance.

Table 4
Summary of hypotheses testing

Hypothesis	ROE Result	ROA Result	Conclusion
H1: Board Independence	Not Significant (p = 0.0841)	Not Significant (p = 0.1680)	**Not Supported**: No positive relationship with financial performance.
H2: Chair/CEO Duality	Significant (p = 0.0020)	Significant (p = 0.0128)	**Not Supported**: Significant **negative** relationship with financial performance.
H3: Audit Committee Activities	Not Significant (p = 0.3704)	Not Significant (p = 0.3644)	**Not Supported**: No positive relationship with financial performance.

The regression results suggest the model is statistically significant for both ROE and ROA (as indicated by the F-test). However, the individual contributions of the independent variables do not align with the hypothesized relationships. All the hypotheses are not supported. Specifically:

1. Board Independence: No significant positive effect on financial performance.
2. Chair/CEO Duality: Significant negative effect on financial performance.
3. Audit Committee Activities: No significant positive effect on financial performance.

Qualitative analysis

A total of 14 professionals were interviewed. All 14 had a minimum of 10 years' director experience or corporate governance experience with small-cap listed companies. Their backgrounds included qualified accountants, financial advisors, corporate governance practitioners, and consultants. Their varied backgrounds gave a nuanced view of the governance challenges facing small-cap listed companies.

From the lived experience of the participants, it showed several recurring themes. For many of the participants, corporate governance is considered as a compliance exercise. Participants said that the company's priority is in meeting listing rules requirements rather than using corporate governance mechanisms to improve operations or financial results. When firms tried to take a more strategic approach in corporate governance, they often ran into limitations on time, budget, and expertise. As one participant put it, "Governance practices are primarily dictated by listing rules compliance, and they were not applied to address operational inefficiencies."

Board independence was widely viewed as important, but its impact is often muted by dominant shareholders. Many independent non-executive directors (INEDs) said they do not have the authority to push back on key decision-makers and which limit their influence. Meanwhile, it is difficult to recruit and retain qualified INEDs when remunerations are low and company resources are tight. Some participants pointed out qualified and effective INEDs can offer good strategic advice and risk management when they are put into action while some commented that their role was largely symbolic. As one noted, “INEDs often lack the authority to challenge dominant shareholders; their ability to influence governance meaningfully is reduced.”

Chair/CEO duality emerged as a major concern amongst the three corporate governance mechanisms. Most participants supported the idea of segregating the chair and CEO roles in order to improve oversight, accountability, and checks and balances. However, several participants noted that combining the two roles, in certain circumstances, can speed up decisions. However, the consensus was that duality concentrates power, limits viewpoints, and raises governance risk. As one participant put it, “Combining the roles might speed things up, but it puts too much power in one person’s hands and weakens accountability.”

Audit committees are critical in ensuring financial reporting accuracy and effective internal control. It can also oversee that risk management policies are properly implemented. Its effectiveness is dependent upon the quality of meetings; members’ professional qualifications; and the level of support from the management. More frequent meetings can help, but participants stressed that meaningful, well-run meetings matter more than meeting frequency. Too many meetings could drain resources, while too few would delay the discovery of issues. As one participant summed up, “Inactive audit committees led to late discovery of problems, while overly frequent meetings drained resources.”

Resource constraints have been a constant theme mentioned by the participants. Tight budgets and small support teams make it difficult to attract qualified directors. The challenge is even greater in family-owned or majority shareholder-controlled firms where keeping the business alive along with profitability often come before compliance. As one participant put it, “Small-cap firms often lack the resources to implement governance practices fully, and their focus remains on survival.”

Participants did not agree that corporate governance directly boosts financial performance. However, some agreed that strong corporate governance builds investor confidence and improves operational efficiencies. Others saw it mainly as good risk management practice rather than as a direct driver of profits. As one participant put it, “Corporate governance will not influence financial performance but will help minimize problems.”

The participants recommended mandatory training in corporate governance and risk management for directors. Companies could also leverage technology and off-the-shelf software to stretch limited resources. The regulators update rules in accordance with industry-specific standards. In addition, regulators and/or professional organizations can build pools of qualified directors to help firms find qualified INEDs. Another suggestion was to raise INED pay to attract and retain talent.

Analysis of hypotheses using qualitative results

Overall, the qualitative findings do not fully support the hypotheses.

H1 not supported. INEDs aid oversight but their influence in small-cap companies is constrained by dominant owners, low remunerations, and limited resources. They did not view corporate governance mechanisms as having an impact on financial performance.

H2 not supported. A few interviewees saw the benefits of efficiency, but most said duality concentrates power, weakens accountability, and narrows viewpoints. The consensus is to split the roles to improve oversight and reduce risk.

H3 partly supported. Audit committee meetings are important, but their effectiveness depends upon the quality of meetings and their members' being competent; it is not just a matter of meeting frequency. Too many meetings waste resources, while too few miss problems**.**

In summary, the qualitative portions of this study support and supplement the quantitative regression analysis findings for all three hypotheses. While the empirical study quantifies the impact of corporate governance mechanisms on financial performance, the qualitative analysis provides essential context and depth explaining why certain governance mechanisms are effective under specific conditions. Together, the two analyses present a cohesive understanding of corporate governance mechanisms and their impact on financial performance in small-cap firms. It emphasizes the importance of reforms, resource allocation, and the adoption of context-sensitive governance strategies.

Please find herein below a table summarizing and comparing the hypothesis testing results between quantitative analysis and qualitative findings:

Table 5

Comparison of hypothesis testing regression results

Hypothesis	Regression Findings	Qualitative Report Insights	Alignment
H1: Board Independence	No significant impact on ROE over six years; limited role in driving financial performance.	Independent Directors improve governance quality but face structural and resource-related barriers, limiting their	Strong alignment: Qualitative findings explain the lack of significant

Hypothesis	Regression Findings	Qualitative Report Insights	Alignment
		effectiveness.	financial impact.
H2: Chair/CEO Duality	Significant negative impact during COVID-19; no significant impact in other periods.	Duality improves efficiency but reduces accountability, with risks magnified during crises due to power concentration and lack of oversight.	Strong alignment: Qualitative findings clarify duality's risks and its negative crisis impact.
H3: Audit Committee Activities	Significant positive impact during COVID-19; no significant impact in stable or recovery periods.	Frequent meetings improve governance during crises but are constrained by limited resources in stable periods.	Strong alignment: Qualitative findings elaborate on the crisis-specific importance of committees.

Conclusion and Recommendations

The study provides important insights into the impact of corporate governance mechanisms on the financial performance of small-cap firms listed on HKEX. The empirical findings together with the conclusions from the qualitative portions of this study's research offer practical recommendations for enhancing impact of corporate governance mechanisms on financial performance.

Board Independence

The study finds there is no significant positive relationship between Board Independence and financial performance. It is likely due to limited expertise of the independent directors. It could also be due to the tick-box compliance practice of the small-cap firms. To address these issues, it is recommended that regulators require independent directors to possess relevant and verifiable industry-specific qualifications or professional experience. In addition, companies should be required to conduct annual evaluations of independent directors' contributions and performance. Such evaluations should be disclosed in the corporate governance report.

Chair and CEO Duality

The study finds that the Chair and CEO role consolidated into one person has a significant negative impact on both operational efficiency (ROA) and shareholder returns (ROE). It highlights the risks of concentrated authority. Regulators should mandate the segregation of the Chair and CEO roles for all listed companies, and for small-cap firms in particular. As a further consideration, it may be good practice to have an independent director appointed as the Chairperson who can provide unbiased and impartial oversight of the board and the executive team. If mandatory segregation is not possible and Chair/CEO duality exists, firms must provide risk mitigation measures and which must be disclosed in the corporate governance report.

Audit Committee Activities

The study indicated that the frequency of audit committee meetings does not impact a firm's financial performance. In response, multiple reforms are suggested. Mandatory training for all audit committee members is needed to ensure that they possess knowledge of financial reporting requirements, risk management procedures, and internal control. The responsibilities of audit committees should be broadened to include the monitoring of risk assessment, cybersecurity, and ESG requirements. Furthermore, regulators could require a minimum number of yearly meetings with agendas focusing on the aforesaid matters. Lastly, the obligatory rotation of external auditors should be periodically installed in order to mitigate complacency and to guarantee impartial assessments of financial accounts.

Tailored Governance Frameworks for Small-Cap Firms

Standardized governance frameworks may not be effective or practical for small-cap firms. It is because their resources are constrained, and they have unique operational environments. Simplified corporate governance mechanisms should be developed specifically for small-cap firms by balancing corporate governance best practices with the operational realities of small-cap firms. Furthermore, it is recommended to have subsidized corporate governance programs in place for small-cap firms by providing qualified independent directors matching services. Centralized professionals should continue to provide training programs for directors and audit committee members or through an authorized service provider. Additionally, it is crucial to implement corporate governance reforms by phase in order to give small-cap firms the time needed to adjust to new regulations without disrupting their operations.

Regulatory reforms specific to the unique characteristics of small-cap firms can significantly improve corporate governance and their impact on financial performance. Strengthening board independence and quality of independent directors by mandating the segregation of Chair and CEO roles; enhancing audit committee effectiveness; and improving transparency are the key recommendations. By addressing the root causes of weak corporate governances, these reforms can create a more accountable and sustainable corporate governance environment for small-cap firms.

Corporate governance is important for all companies large or small. Many small-caps struggle to implement it because of limited resources, cultural factors, and a box-ticking mentality of compliance. Corporate governance mechanisms affect financial performance with some mechanisms more effective than others. Companies should use them as a strategic lever to build resilience and market trust. They should not just treat them as a compliance task.

This study focuses on small-cap firms listed on HKEX, a segment that is often overlooked. Practical steps are recommended in this study in order to raise corporate governance standards. Specifically, this study emphasizes the need for context-specific frameworks that could balance rules with operating realities so that corporate governance is both practical and effective.

Future studies should examine how technology, especially artificial intelligence tools, can help ease resources constraints. Furthermore, compulsory training programs are to be implemented as improvement of governance effectiveness. It should also analyse the impact of corporate governance mechanisms, other than those discussed in this study and specifically on the financial performance of small-cap companies listed on the HKEX. Studies can also be conducted on small-caps of other regional markets like those in Singapore and Taiwan.

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