

CORPORATE GOVERNANCE, FINANCIAL DISTRESS AND FIRM PERFORMANCE

Ha Thi Nguyet*

Abstract: *In an increasingly volatile economic environment, financial distress poses significant challenges to firm sustainability and performance. To mitigate these risks, corporate governance has been extensively studied in the financial sector for its role in enhancing transparency, accountability, and informed strategic decision-making. Therefore, this paper will examine the impact of corporate governance and financial distress on firm performance of Vietnamese manufacturing firms. The data includes 162 firms listed on the Hanoi and Ho Chi Minh Stock Exchanges from 2019 to 2023. The methodology employed in this paper is the Generalized Least Squares method with Fixed effects model on panel data to measure both accounting-based (Return on Assets - ROA) and market-based (Tobin's Q) performance. The results reveal that financial distress has a powerful and consistently negative impact on firm performance. Among the governance components, greater female representation on the board is found to have a significant and negative effect on financial performance (Tobin's Q only); neither board size nor audit quality showed a statistically significant impact on firm performance.*

• Keywords: corporate governance, financial distress, firm performance, manufacturing firms, Vietnam.

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1. Introduction

Corporate governance has become more relevant in contemporary times as companies expand and grow both in developed and emerging economies (Freeman, 1983, 2010). However, there is no consensus on the magnitude and signs of several corporate governance provisions in existing studies. Therefore, it is important to further research corporate governance and find out how it affects financial performance. Additionally, it is highly relevant to analyze the impact, especially when firms are under financial distress. The financial distress in this paper will be closer to the practical situation of the business, rather than the unusual global crisis. There is little empirical evidence of the relationship between corporate governance, financial distress, and firm performance in Vietnam. Therefore, the research will contribute to the empirical literature on the association among all the mentioned indicators in emerging countries.

The remainder of this paper is structured as follows. It starts with the literature review and theoretical framework to motivate the studied variables. After that, the paper moves on to present the analysis in the method section. The paper then continues to describe the data, interpret, and discuss the results. It ends with the conclusion of the contributions and limitations.

2. Literature review

2.1. Corporate governance

In recent decades, the nexus between corporate governance, financial distress, and firm performance

has attracted considerable scholarly attention. The prevailing evidence supports the notion that effective governance mechanisms are positively associated with firm performance (Stanwick & Stanwick, 2002), although a stream of literature offers divergent findings and emphasizes potential limitations of this relationship (Donaldson & Davis, 1991; Ehikioya, 2009; Jensen & Meckling, 1976). According to Rezaee (2008), good corporate governance can contribute to the health of the companies and can have a positive impact on society, such as by having the board make less risky investment decisions to benefit investors or conducting more pro-social corporate practices to improve firms' reputation and financial returns.

Firms often rely on external financing to undertake expansion projects, and evidence suggests that strengthening corporate governance mechanisms can enhance firm value by approximately 10 to 12% (Stanwick & Stanwick, 2002). According to Weir (1997), firms with weak or "undesirable" governance structures often face greater difficulty in securing funding, such as bank loans. Similarly, Mallin (2016) emphasizes that investors consider factors such as insider ownership, the presence of audit committees, board independence, board size, and CEO duality when evaluating firms. As a result, corporations have increasingly implemented strong governance frameworks to build investor confidence and secure the financial resources required for sustainable growth.

* Hanoi University; email: nguyethanu17@gmail.com

2.2. Financial distress

Financial distress is a critical concept in corporate finance, commonly defined as a situation in which a firm experiences difficulties in meeting its financial obligations or sustaining normal operations due to declining revenues, profitability, or asset values (Whitaker, 1999). It is widely regarded as a precursor to bankruptcy, but its implications extend far beyond potential failure. Given these consequences, financial distress has been extensively studied in relation to firm performance, not only to understand its direct negative effects but also to capture the conditions under which firms remain resilient despite financial pressures.

Moreover, most existing studies emphasize the role of corporate governance in predicting or reducing the likelihood of financial distress, rather than evaluating its influence on firm performance once distress has already materialized. Given these theoretical and empirical insights, it is reasonable to expect that financial distress exerts a significant negative influence on firm performance.

2.3. Research gaps

The findings of this study are hoped to contribute to the literature about financial performance in two measures, including ROA and Tobin's Q. To the best of the researcher, this is the first study that tried to find out the impact of corporate governance and financial distress separately on firm performance. In addition, this study is expected to provide managers of firms listed on the Hanoi Stock Exchange (HNX) and Ho Chi Minh City Stock Exchange (HOSE), and other interested parties (e.g., investors, creditors, and financial analysts) with knowledge about the impact of corporate governance on financial performance. This helps them in making different decisions about investing in companies or enhancing the company's performance.

The results can also show the effectiveness of gender equality mandates, in response to the pressure from the press and the public (Adams & Ferreira, 2008), while addressing the skepticism towards the role of board independence in reducing the principal-agent problems with better monitoring and objective perspectives (Klein, 1998). Lastly, it gives recommendations for the board selection procedure, specifically on the education qualifications and experience requirements for directors' appointments. Thus, it also aims to answer the research question: "What is the impact of corporate governance and financial distress on the firm performance of manufacturing firms in Vietnam?"

3. Methodology

In this paper, a sample of 162 manufacturing firms out of the total of 362 listed and collected on the Hanoi and Ho Chi Minh Stock Exchanges from 2019 to 2023 is selected for analysis. The methodology employed

in this paper is the Generalized Least Squares method with Fixed Effects model on panel data to measure both accounting-based (Return on Assets - ROA) and market-based (Tobin's Q) performance. Return on Assets (ROA) serves as an indicator of how efficiently a firm utilizes its assets to generate earnings. It is computed by:

$$ROA = \frac{\text{Net Income}}{\text{Total Assets}} (\%)$$

Tobin's Q is defined as the ratio of a firm's market value, which includes the market value of its outstanding equity and debt, to the replacement cost of its assets, typically approximated by their book value (Christensen et al., 2010).

$$\text{Tobin's Q} = \frac{\text{Market Cap} + \text{Total Liabilities}}{\text{Total Assets}}$$

A software data analysis package in Eviews was used to test the data along with a multivariate analysis to obtain descriptive statistics of the total variables. Next, the correlation method is applied to estimate the relationship between independent, dependent, and control variables. Multiple linear regressions are "finally" employed to test the impact of corporate governance mechanisms and financial distress on firms' financial performance among selected companies.

This paper will use the Z-score since it is a good indicator for financial distress, and the higher the Z-score, the lower the chance of financial distress (Shahwan, 2015). It is advantageous to utilize the Z-score as it has been used many times in the research surrounding the estimation of financial distress. The firm is in financial distress when the Altman Z-score is under 1.8 since the firm will go bankrupt (Altman, 1968). Therefore, the financial distress is a dummy variable where it takes on 1 if "Distress zone" is recognized and it takes on 0 otherwise. Z-score for manufacturing firms is computed as:

$$\text{Altman Z-score} = 1.2 * x_1 + 1.4 * x_2 + 3.3 * x_3 + 0.6 * x_4 + 1 * x_5$$

Where:

$$x_1 = \frac{\text{Working capital}}{\text{Total assets}}$$

$$x_2 = \frac{\text{Retained earnings}}{\text{Total assets}}$$

$$x_3 = \frac{\text{Earning before interest and tax (EBIT)}}{\text{Total assets}}$$

$$x_4 = \frac{\text{Market capitalization}}{\text{Total liabilities}}$$

$$x_5 = \frac{\text{Sales}}{\text{Total assets}}$$

Drawing on previous research by Guest (2009), Jackling and Johl (2009), and Alfaraiah, Alanezi, and Almujaed (2012), this study proposes two regression

models to determine relations between good corporate governance mechanisms and the financial performance of firms. The two model equations are:

i. Accounting performance will be:

$$ROA = \beta_0 + \beta_1 BS + \beta_2 Female_BS + \beta_3 Audit + \beta_4 Distress + \beta_5 \log(TA) + \beta_6 Leverage + \beta_7 Covid + u_i \quad (1)$$

ii. Market performance will be:

$$\log(Tobinq) = \beta_0 + \beta_1 BS + \beta_2 Female_BS + \beta_3 Audit + \beta_4 Distress + \beta_5 \log(TA) + \beta_6 Lev + \beta_7 Covid + u_i \quad (2)$$

Based on the findings from previous studies, the hypotheses developed are as exhibited below:

H1: Board Size has a positive and significant impact on the Firm Performance.

H2: Female Board Member has a positive and significant impact on the Firm Performance.

H3: Audit Quality has a positive and significant impact on the Firm Performance.

H4: Financial Distress has a negative and significant impact on the Firm's performance.

Table 1: Description of variables

Variable type	Variable name	Definition and measurement
Dependent variables	ROA	Return on assets, measured as Net income/Total assets (%)
	TOBINQ	Tobin's Q, measured as (Market Cap + Total liabilities)/Total assets
Independent variables	BS	Board size, measured as the number of board of directors on the company's board.
	Female_BS	Female board member, measured as the number of female board members over board size.
	Audit	Audit quality, measured as 1 if the company's financial statement is audited by large auditors like Big 4 firms, 0 otherwise
	Distress	Financial distress, measured as 1 if the Z-score gives the result with "Distress zone", 0 otherwise
Control variables	Size	Firm size, measured as the logarithm of Total assets
	Leverage	Leverage, measured as the amount of debt within a firm
	Covid	The effect of the COVID-19 pandemic on financial performance as 1 if year are 2021 and 2022, 0 otherwise

4. Quantitative models

4.1. Descriptive statistics

This section provides a discussion of the descriptive statistics for the variables used in this study.

The profitability of firms, measured by Return on Assets (ROA), shows considerable variation with a mean of 7.4% and a high coefficient of variation (94.6%), while the skewness (2.48) and kurtosis (12.82) indicate a right-skewed distribution with heavy tails, suggesting that a few firms are substantially more profitable than others. In terms of market-based performance, Tobin's Q initially displayed extreme variation, but a log transformation improved normality, reduced outlier

effects, and enhanced statistical reliability, yielding a mean of 11.7% with a low coefficient of variation (3.42%) and a moderately skewed, peaked distribution (Skewness = 0.89; Kurtosis = 5.41), consistent with best practices in financial research (Gujarati & Porter, 2009; Wooldridge, 2010). Regarding corporate governance variables, board size averages five to six members with relatively low variation (23.74%), while female board representation remains low at 15.7% on average but highly dispersed (Cov = 114.65%). Audit quality (AQ), measured as a Big 4 auditor dummy, averages 0.293, showing that about 29% of firms employ Big 4 auditors. Financial distress (FD), also a dummy variable, averages 0.167, indicating that 16.7% of firms experienced distress, though its high coefficient of variation (221.56%) reflects its rare occurrence. Among control variables, total assets were log-transformed to mitigate scale differences, reduce skewness, and improve comparability, with the transformed firm size (Size) averaging 27.71, a standard deviation of 1.61, and low variation (5.81%), while leverage averages 46.4% with moderate variability. Finally, the COVID-19 dummy variable records a mean of 0.80, reflecting that most observations fall within the pandemic period.

Table 2: Summary of descriptive statistics

Variable	Min.	Max.	SD	Mean	Cov. (%)	Skew.	Kurt.
ROA	-0.02	0.65	0.07	0.074	94.60	2.48	12.82
LOG(Tobinq)	-1.41	2.52	0.40	0.117	3.42	0.89	5.41
BS	3.00	15.00	1.34	5.644	23.74	1.13	5.86
Female_BS	0.00	1.00	0.18	0.157	114.65	1.00	3.53
Audit	0.00	1.00	0.46	0.293	157.00	0.91	1.83
Distress	0.00	1.00	0.37	0.167	221.56	1.79	4.19
LOG(TA)	23.55	32.87	1.61	27.71	5.81	0.36	3.12
Leverage	0.02	0.97	0.21	0.464	45.26	0.06	2.10
Covid	0.00	1.00	0.40	0.80	50.00	-1.50	3.25

The descriptive statistics reveal substantial variation in firm performance, governance structures, and financial characteristics. The high skewness and kurtosis in ROA highlight potential non-normality, while the logarithmic transformations of TQ and TA effectively improved distributional properties. The binary nature of audit quality, financial distress, and COVID-19 variables is evident, and the moderate to high coefficients of variation emphasize firm heterogeneity, providing a strong basis for subsequent regression analysis.

4.2. Correlation matrix

Table 3 presents the correlations among the dependent variable ROA, the independent variables, and the control variables, while their correlations with Tobin's Q are shown in Table 4. According to Gujarati and Porter (2009), a correlation coefficient above 0.8 may indicate the presence of multicollinearity in the dataset. The results in Tables 3 and 4 suggest that multicollinearity is unlikely to pose a problem in this study.

Table 3: Correlation between ROA and Independent variables

Variable	ROA	BS	Female_BS	Audit	Distress	LOG(TA)	Leverage	Covid
ROA	1							
BS	0.0772	1						
Female_BS	0.1292	-0.0060	1					
Audit	0.0702	0.1704	0.0322	1				
Distress	-0.3206	-0.0569	-0.0697	-0.0535	1			
LOG(TA)	-0.0913	0.3404	-0.0651	0.4101	0.1702	1		
Leverage	-0.5255	0.0069	-0.1700	-0.0044	0.4450	0.3173	1	
Covid	-0.0018	-0.0121	0.0150	-0.0030	-0.0615	0.0427	-0.0360	1

There are mixed results: several variables are negatively correlated to ROA, whereas others have a positive correlation with ROA. The findings indicate that the correlation is negative for Distress = -0.32, LOG(TA) = -0.09, Leverage = -0.53, and Covid = -0.001. All other variables have a positive correlation with ROA: BS = 0.07, Female_BS = 0.13, and Audit = 0.07. This suggests that an increase in any of these variables triggers increases of ROA, whereas variables Distress, Size, Leverage, and COVID-19 pandemic also decrease when ROA decreases.

Table 4: Correlation between Tobin's Q and independent variables

Variable	LOG (Tobinq)	BS	Female_BS	Audit	Distress	Size	Leverage	Covid
Log(Tobinq)	1							
BS	0.2270	1						
Female_BS	0.0750	-0.0060	1					
Audit	0.1825	-0.1704	0.0322	1				
Distress	-0.2283	-0.0569	-0.0697	-0.0535	1			
Size	0.1316	0.3404	-0.0651	0.4101	0.1702	1		
Leverage	-0.2057	0.0069	-0.1700	-0.0044	0.4450	0.3173	1	
Covid	0.0733	-0.0121	0.0150	-0.0030	-0.0615	0.0427	-0.0360	1

Concerning TQ and corporate governance mechanisms (Table 5), again, multicollinearity is unlikely to be a problem. Furthermore, only variables, Distress and Leverage have a negative correlation with TQ (-0.22, -0.21, respectively), suggesting that when these corporate governance variables decrease, TQ also decreases. The variables BS, Female_BS, Audit, Size, and Covid have a positive correlation with TQ, suggesting that these variables increase at the same time as TQ.

In summary, the correlation analysis provides several key insights into the factors associated with firm performance. Good corporate governance practices, such as having a more gender-diverse board and higher audit quality, appear to be positively associated with both accounting-based and market-based performance. On the other hand, higher leverage and distress are strongly linked to poorer performance, particularly in terms of profitability. However, it is crucial to acknowledge the limitations of this correlation analysis. Correlation does not imply causation, and these results only indicate the direction and strength of linear associations between variables. A more robust analysis using multiple regression would be necessary

to control for the simultaneous effects of these variables and to make more definitive claims about their impact on firm performance.

4.3. Multivariate regression results for ROA and Tobin's Q

This study considered three standard models: Pooled Ordinary Least Squares (OLS), the Random Effects Model (REM), and the Fixed Effects Model (FEM). A comparative analysis and a series of diagnostic tests were performed to identify the most suitable specification. An initial review of the models' explanatory power revealed that the FEM vastly outperformed the others, yielding an adjusted R-squared of 0.6902 for the ROA model and 0.7621 for the TQ model, compared to much lower values for both the Pooled OLS and REM regressions. To formally justify the model choice, two key statistical tests were conducted. Based on the unambiguous results of both the Redundant Fixed Effects and Hausman tests, the Fixed Effects Model (FEM) is selected as the most appropriate and robust estimator for this analysis. The subsequent interpretation of results will be based on the findings from this model.

Table 5: Multivariate regression results for ROA and Tobin's Q

Variable	Coefficients (x100)	t-test	p-value	Variable	Coefficients (x100)	t-test	p-value
Multiple regression results for ROA				Multiple regression results for Tobin's Q			
Intercept	0.3578	1.501	0.1339	Intercept	3.9188	2.516	0.0121
BS	0.0039	1.553	0.1209	BS	0.0305	1.841	0.0661
Female_BS	0.0102	0.492	0.6231	Female_BS	-0.3314	-2.443	0.0149
Audit	0.0149	1.386	0.1661	Audit	-0.0492	-0.701	0.4838
Distress	-0.0138	-1.769	0.0774	Distress	-0.1327	-2.600	0.0095
Size	-0.0095	-1.091	0.2755	Size	-0.1089	-1.920	0.0553
Leverage	-0.1117	-3.804	0.0002	Leverage	0.4403	2.294	0.0221
Covid	0.0102	2.915	0.0037	Covid	0.0771	3.381	0.0008
Regression statistics				Regression statistics			
R ²	0.6902			R ²	0.8115		
Adjusted R ²	0.6090			Adjusted R ²	0.7621		
DW	2.279			DW	1.723		
Observations	810			Observations	810		

The regression results for both accounting-based performance (ROA) and market-based performance (Tobin's Q) reveal mixed evidence on the influence of corporate governance and financial distress among manufacturing firms. Board size, consistent with H1, shows a positive relationship with performance in both models ($\beta = 0.0039$ for ROA; $\beta = 0.0305$ for Tobin's Q), but these effects are statistically insignificant ($p = 0.1209$; $p = 0.0661$). Thus, larger boards appear to provide some monitoring capacity, but the benefits are not strong enough to translate into measurable performance, leading to the rejection of H1.

Female board representation shows a positive but insignificant effect on ROA ($\beta = 0.0102$, $p = 0.6231$), while Tobin's Q reveals a significant negative relationship ($\beta = -0.3314$, $p = 0.0149$). These findings contradict H2, suggesting that gender diversity is not yet valued by the market and may even be perceived

negatively in Vietnam, consistent with emerging market contexts where institutional support for diversity is limited. Audit quality, proxied by Big 4 auditor engagement, also fails to yield a significant impact ($p = 0.1661$ for ROA; $p = 0.4838$ for Tobin's Q), indicating that external auditing does not significantly influence performance, thereby rejecting H3.

By contrast, financial distress emerges as the most influential variable. The coefficients are negative in both models ($\beta = -0.0138$ for ROA; $\beta = -0.1327$ for Tobin's Q), with marginal significance for ROA ($p = 0.0774$) but strong significance for Tobin's Q ($p = 0.0095$). This provides partial support for H4 and highlights that distress reduces firm value, with investors reacting more strongly in market-based evaluations than accounting returns. Among the controls, leverage shows a negative and significant effect on ROA but a positive effect on Tobin's Q, while firm size is weakly negative in both models. The COVID-19 dummy is significantly positive in both cases, suggesting firms adapted effectively during the pandemic.

Overall, the regression results indicate that corporate governance mechanisms, namely board size, female board representation, and audit quality, do not exhibit statistically significant effects on accounting-based performance (ROA). This aligns with prior research documenting inconclusive relationships between board characteristics and profitability, particularly in emerging markets (Dalton et al., 1999; Guest, 2009). Similarly, audit quality shows no significant impact on firm performance, consistent with Francis and Yu (2009), who suggest that the role of external auditors is more closely tied to earnings credibility than to direct firm outcomes. Interestingly, while in this study, female board representation shows a negative and significant association with market-based performance (Tobin's Q), there are divided opinions about this matter in prior studies, where gender diversity has sometimes been linked to reduced valuation due to potential tokenism or weaker influence in decision-making (Adams & Ferreira, 2009). Overall, these results support the view that the effectiveness of governance mechanisms is context-dependent, and in the case of Vietnam, external factors such as firm size, leverage, and macroeconomic shocks (e.g., COVID-19) appear more influential determinants of performance (Bebchuk & Weisbach, 2010; Claessens & Yafeh, 2012).

5. Conclusion

This study investigates the impact of corporate governance mechanisms and financial distress on firm performance among 162 manufacturing firms listed on the HNX and HOSE during 2019–2023. Firm performance was measured using both Return on Assets (ROA) and Tobin's Q, representing accounting-based and market-based performance. The findings reveal that corporate governance variables such as board

size, female board representation, and audit quality do not have significant positive effects on performance. By contrast, financial distress exerts a strong negative influence, particularly on Tobin's Q, underscoring its importance as a determinant of market valuation. Control variables further highlight the contrasting effects of leverage and the positive role of firms' adaptation during the COVID-19 period. From a sectoral standpoint, these results align with the characteristics of Vietnam's manufacturing industry, which is capital-intensive, export-oriented, and highly exposed to financial fragility. In such a context, investors appear more responsive to signals of distress than to governance arrangements, while pandemic-related resilience reflects the sector's adaptability and government support.

Several constraints should be acknowledged in interpreting the findings. The analysis is confined to manufacturing firms, which may limit the generalizability to other sectors where governance mechanisms and performance drivers differ. Governance is also assessed using only three indicators, excluding other potentially relevant dimensions such as ownership concentration, board independence, and executive incentives. Moreover, the study period coincides with the COVID-19 pandemic, which may have influenced firm outcomes in ways not fully captured by the models. Future research should expand the sample to include multiple industries, incorporate a broader range of governance variables, and employ advanced econometric techniques to address issues of endogeneity and dynamic effects. Comparative studies across ASEAN economies could further elucidate how institutional settings influence the governance–performance relationship. Overall, the findings contribute to the existing literature by presenting evidence from Vietnam, demonstrating that although governance remains a significant factor, financial stability appears to be the more immediate determinant of performance, underscoring the importance of strategies aimed at mitigating financial distress while fostering long-term enhancements in governance practices.

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