“The paradox of independent board members and financial return of state-owned enterprises: Case of Lithuania”

AUTHORS

Donatas Voveris
Andrius Jaržemskis
Ieva Girdvainienė

ARTICLE INFO	Donatas Voveris, Andrius Jaržemskis and Ieva Girdvainienė (2024). The paradox of independent board members and financial return of state-owned enterprises: Case of Lithuania. *Problems and Perspectives in Management*, *22*(1), 205-217. doi:10.21511/ppm.22(1).2024.18
DOI	http://dx.doi.org/10.21511/ppm.22(1).2024.18
RELEASED ON	Friday, 19 January 2024
RECEIVED ON	Thursday, 09 November 2023
ACCEPTED ON	Friday, 05 January 2024
LICENSE	This work is licensed under a Creative Commons Attribution 4.0 International License
JOURNAL	"Problems and Perspectives in Management"
ISSN PRINT	1727-7051
ISSN ONLINE	1810-5467
PUBLISHER	LLC “Consulting Publishing Company “Business Perspectives”
FOUNDER	LLC “Consulting Publishing Company “Business Perspectives”

BUSINESS PERSPECTIVES

LLC "CPC "Business Perspectives"
Hryhorii Skovoroda lane, 10,
Sumy, 40022, Ukraine

www.businessperspectives.org

Donatas Voveris (Lithuania), **Andrius Jaržemskis** (Lithuania),
Ieva Girdvainienė (Lithuania)

THE PARADOX OF INDEPENDENT BOARD MEMBERS AND FINANCIAL RETURN OF STATE-OWNED ENTERPRISES: CASE OF LITHUANIA

Abstract

The relationship between governance measures and company performance is a widely debated topic in economics, finance, and organizational analyses with diverse outcomes in the existing scholarly body of work. This study aims to examine the relationship between the share of independent members on the board and the financial return of state-owned enterprises. Lithuania was chosen as a setting for the research because the country has been successfully implementing ambitious corporate governance reforms in the public sector and thus is recognized by the Organisation for Economic Co-operation and Development for its efforts. Within the examined dataset of 27 Lithuanian state-owned enterprises spanning 2015 to 2021, there was a notable rise in the proportion of independent board members, ascending from 13% in 2015 to 61% in 2021. However, no statistically significant correlation is discerned between the share of independent board members and financial performance indicators, specifically return on assets (r (181) = –0.020, $p > 0.05$) and return on equity (r (181) = –0.104, $p > 0.05$). The quantitative results are complemented through the administration of semi-structured interviews with a subset of board members affiliated with these enterprises. The absence of a relationship between independent board members and the financial return is explained via a more significant influence of state decisions than the effect of a board. Therefore, the appointment of independent board members alone cannot be regarded as the sole guarantor of improvement in financial returns.

Received on: 9th of November, 2023
Accepted on: 5th of January, 2024
Published on: 19th of January, 2024

Donatas Voveris, Ph.D. Candidate, Department of Management, Faculty of Economics and Business Administration, Vilnius University, Lithuania. (Corresponding author)

Andrius Jaržemskis, Ph.D., Department of Business, Faculty of Economics and Business Administration, Vilnius University, Lithuania.

Ieva Girdvainienė, Ph.D. Candidate, Department of Management, Faculty of Economics and Business Administration, Vilnius University, Lithuania.

Conflict of interest statement:
Author(s) reported no conflict of interest

Keywords state-owned enterprise, independent board member, corporate governance, governance reform

JEL Classification G38, H82, M21, O16

INTRODUCTION

In the aftermath of the 2008 financial crisis, the focus on corporate governance intensified, prompting heightened scholarly attention to effective governance attributes (Curi et al., 2016). The intricate relationship between board composition, decision-making processes, and company performance has been the subject of extensive investigation within management and corporate finance (Liu et al., 2015; Wagner, 2011). The Organisation for Economic Co-operation and Development (OECD) asserts that well-crafted corporate governance policies can significantly contribute to broader economic objectives. The OECD is dedicated to ensuring that state-owned enterprises operate within a robust competitive and regulatory framework (OECD, 2015).

Many countries, including emerging markets, have adapted their corporate governance regulations to enhance the presence of independent board members on corporate boards, drawing inspiration from the United States (Wagner, 2011). The debate surrounding independent board members has generated conflicting outcomes and diverse opinions. Specifically, some studies report significantly negative associa-

http://dx.doi.org/10.21511/ppm.22(1).2024.18

tions, others identify notable positive correlations, and yet others reveal insignificant links. Hence, the presence of unresolved empirical dilemmas within the organizational sciences literature concerning the correlation between independent board members and company performance necessitates further research (Souther, 2021; Uribe-Bohorquez et al., 2018; Ramdani & van Witteloostuijn, 2010).

Within the domain of state-owned enterprises, governance issues can have a profound impact since the performance of these enterprises impacts entire economies (Böwer, 2017; Ryan Jr. & Wiggins III, 2004). Despite some empirical evidence suggesting a positive relationship between the financial performance of state-owned enterprises and board composition (Abang'a et al., 2022; Hermanto et al., 2021; Jurkonis et al., 2016), as well as a favorable correlation between independent board members and the economic success of these enterprises (Abang'a et al., 2022; M. & Sasidharan, 2020; Cheng & Ng, 2018), the existing evidence remains limited.

1. LITERATURE REVIEW

The relationship between corporate governance mechanisms and company performance is a highly discussed subject in economics, finance, and organizational studies, involving both theoretical and practical elements with varying results in the present body of work (Wagner, 2011; Ramdani & van Witteloostuijn, 2010).

1.1. Independent board members and company performance

Two main theories, the agency theory and the stewardship theory, are employed to explain the relationship between independent board members and company performance (Rutledge et al., 2016). According to Jensen and Meckling (1976), the agency theory posits that agency relationships involve principals and agents with divergent objectives, making independent board members crucial for effectively monitoring chief executive officers (CEOs) (Huse, 1994; Ramdani & van Witteloostuijn, 2010). Independent board members are defined as board members who are independent of the company, its employees, and shareholders and are entrusted with overseeing the governance process (Hoitash, 2011; Menozzi et al., 2012). They are expected to have minimal or no conflicting interests in the companies they oversee (Koerniadi & Tourani-Rad, 2012), acting on behalf of shareholders to mitigate agency problems and provide impartial business insights and strategic direction (Lefort & Urzúa, 2008; Fuzi et al., 2016). Rutledge et al. (2016) find that this can improve company performance. Conversely, the stewardship theory suggests that board members and managers act as caretakers representing shareholders and are driven by a desire to fulfill their duties. This makes a predominantly inside-member board advantageous for effective decision-making due to their superior company knowledge (Rutledge et al., 2016).

According to Singhchawla et al. (2011), independent board members enhance corporate performance as they can actively examine managerial behavior. Liu et al. (2015) provide evidence that independent board members play an essential role in improving investment efficiency, while Bozec and Dia (2007) and Uribe-Bohorquez et al. (2018) argue that independent board members increase the company's technical efficiency. Representation of independent members on the board demonstrates a favorable correlation with company performance. Hence, shareholders' financial concerns are optimally catered to when the board sustains its independence (Leung et al., 2014; Liu et al., 2015; Fuzi et al., 2016; Kanakriyah, 2021; Souther, 2021).

Conversely, Rutledge et al. (2016) do not find a significant relationship between the proportion of independent board members and company performance. Some researchers in the field even observe a negative relationship between board independence and company performance. For example, according to Koerniadi and Tourani-Rad (2012), independent board members in New Zealand negatively affect company value instead of adding value. Shan (2019) comes to the same conclusion using a sample of Australian listed companies, Musleh Alsartawi (2019) – a sample of Islamic banks, and Al-Saidi (2021) – a sample of non-financial listed companies in Kuwait. Bøhren

http://dx.doi.org/10.21511/ppm.22(1).2024.18

and Staubo (2016) show that Norwegian companies experience a decline in value when there is a higher proportion of independent members on the board, as it is assumed that companies require guidance from non-independent board members to a greater extent than monitoring from independent board members.

The relationship between independent board members and company performance may vary depending on the specific context of a company. For example, Gani and Jermias (2006) suggest that the relationship is more evident in companies pursuing cost-efficient strategies than those pursuing innovation. On the other hand, Ramdani and van Witteloostuijn (2010) argue that independent board members provide limited or no benefits to extremely low-performing companies, as they require a mediator to secure external resources rather than robust monitoring.

1.2. Economic importance, governance, and performance of state-owned enterprises

State-owned enterprises are government-controlled companies that play a significant role in various economies, contributing substantially to the gross domestic product and often operating as monopolies in essential sectors (Böwer, 2017; Curi et al., 2016; Heo, 2018; Kloviene et al., 2015; Wong, 2018). Their performance, whether positive or negative, can have far-reaching effects on the entire economy (Ryan Jr. & Wiggins III, 2004). However, poorly managed state ownership of state-owned enterprises can pose macroeconomic hazards, affecting fiscal policy, financial stability, and overall economic competitiveness (Böwer, 2017). Given their role as providers of critical public amenities, the efficiency of state-owned enterprises significantly impacts citizens' well-being and economic expansion through productivity spillovers (Kloviene et al., 2015).

State-owned enterprises often prioritize social and political goals, such as wealth distribution and employment, over profit maximization (Ryan Jr. & Wiggins III, 2004). Jurkonis and Aničas (2015) and Okhmatovskiy et al. (2022) find that the governance of state-owned enterprises is crucial as they must balance commercial objectives with state shareholders' preferences. As hybrid organizations, state-owned enterprises operate as commercial companies and as instruments to execute governmental policies. Accordingly, the effectiveness of state-owned enterprise governance is influenced by varying institutional quality, which can exacerbate risks (Böwer, 2017). Simpson (2014) and Ilham et al. (2022) emphasize the importance of effective board leadership in setting development objectives and strategies to enhance performance in state-owned enterprises. Even in countries where state-owned enterprises are expected to operate commercially, the quest for improved performance persists. Governments seek to enhance state-owned enterprise performance by adjusting governance practices and focusing on independent board members (Kumar et al., 2021).

Efforts to strengthen state-owned enterprise governance have lagged behind advancements in the private sector, but recent endeavors in developed and developing nations aim to narrow this gap (Ryan Jr. & Wiggins III, 2004; Curi et al., 2016; Heo, 2018). Corporate governance reforms focusing on state-owned enterprise restructuring are vital for enhancing efficiencies (Curi et al., 2016). Heo (2018) and Guan et al. (2021) provide evidence of a significant correlation between state-owned enterprise performance and corporate governance, considering other influential factors. Jurkonis et al. (2016), Abang'a et al. (2022), and Hermanto et al. (2021) support this perspective through their empirical studies, revealing a noteworthy positive relationship between state-owned enterprises' financial performance and board composition.

The OECD recommends that countries implement corporate governance principles and improve state-owned enterprises' boards by appointing competent and independent board members. Countries that have adopted these principles have reported enhanced board discussions and improved state-owned enterprises' performance (Jurkonis et al., 2016). Kumar et al. (2021) suggest that having a significant proportion, if not a majority, of independent board members on state-owned enterprises' boards is the most effective approach. Cheng and Ng (2018), M. and Sasidharan (2020), and Abang'a et al. (2022) empirically show a positive relationship between independent members on a board and the financial performance of state-owned enterprises.

1.3. Case of Lithuania

State-owned enterprises in Lithuania play a crucial role in the nation's economy and well-being, operating in vital sectors and contributing significantly to economic growth, employment, tax revenue, and the provision of essential services to the public and businesses. They also manage critical assets, including the port of Klaipeda, railways, electricity and gas supply infrastructure, airports, and state forests. With around 30 thousand employees, state-owned enterprises in Lithuania account for 6.4% of the country's gross domestic product.

Lithuania became a member of the OECD in 2018. As part of the initiation process, the country had to fully depoliticize the governance of its state-owned enterprises and reduce the number of state-owned enterprises by privatizing or shutting down state-owned enterprises in activities that are not strategic for public interest and/or can be fully implemented by the private sector. Accordingly, in the 12 years since the start of the reforms in 2010, the number of state-owned enterprises in Lithuania has decreased from 150 to 47 (see Table 1). Even before joining the OECD, the Lithuanian government implemented a series of reforms over a decade to address inefficiencies in the state-owned enterprises. These reforms aimed to adopt best governance practices from international organizations. For example, the country has established a robust monitoring and coordination mechanism through the Governance Coordination Center. The Governance Coordination Center collects and disseminates comprehensive information on the performance and governance practices of Lithuania's state-owned enterprises. It also performs critical shareholder functions by participating in state-owned enterprise board nomination processes and serving as a consultative/advisory body (OECD, 2022).

Table 1. Key indicators of state-owned enterprises in Lithuania in 2010, 2015 and 2021

Source: Governance Coordination Center (2011, 2016, 2022).

Indicator	2010	2015	2021
Number of state-owned enterprises	150	128	47
Asset value, bn. euro	8.54	9.2	14.40
Equity, bn. euro	5.13	5.2	7.81
Revenue, bn. euro	1.88	2.49	3.52
Profit, bn. euro	0.017	0.159	0.280
Profitability, %	0.90	6.39	7.95

Although the governance reforms for state-owned enterprises in Lithuania were initiated in 2010, the study commences the investigation starting from 2015, following the trajectory of Jurkonis et al. (2016), who examined the financial performance of Lithuanian state-owned enterprises from 2012 to 2014. The data on state-owned enterprises up to the most recent available point in time as of the writing of this paper, which is 2021, were utilized.

Subsidiaries of state-owned enterprises meet the legal definition of a state-owned enterprise according to the Law on State and Municipal Enterprises of the Republic of Lithuania (Seimas of the Republic of Lithuania, 2022), which designates a state-owned enterprise as a company established or transferred to the state from state property, owned by the state, and responsible for managing, using, and disposing of the transferred or acquired property in a fiduciary capacity. In some cases, such enterprises may rank among the largest companies in the country. However, the Governance Coordination Center does not include subsidiaries in its classification of state-owned enterprises. As a result, this study solely focuses on state-owned enterprises as listed officially by the Governance Coordination Center.

The G20/OECD Principles of Corporate Governance (OECD, 2015) state that companies with supervisory, regulatory, and enforcement roles should have operational independence, accountability, adequate powers, resources, and capacity to effectively perform their duties, particularly in corporate governance. These principles are typically executed through independent boards. As a priority recommendation to Lithuania, the OECD urges empowering independent state-owned enterprise boards (OECD, 2022).

Following the regulatory framework in Lithuania, the official term of the board at state-owned enterprises is set at 4 years. Since 2015, formal regulations were established in Lithuania stating that 50% of board members of state-owned enterprises must be independent. The criteria for assessing board member independence are stipulated in the regulations established by the Government of Lithuania. After each financial year, state-owned enterprises must disclose the independence status of all board members in their annual reports and reports to the Governance Coordination Center.

http://dx.doi.org/10.21511/ppm.22(1).2024.18

While in 2015 only 13% of board members at state-owned enterprises were independent, at the end of 2018, the share of independent members on the boards of state-owned enterprises reached the goal of 50% and has remained at a similar level (see Table 2). Also, since the beginning of 2018, there have been no more politicians on the boards of state-owned enterprises.

Table 2. Independent board members and state-owned enterprise return in Lithuania, 2015–2021

Source: Governance Coordination Center (2016, 2018, 2022).

Period	Share of independent board members, %	ROE, %	ROA, %
2015	13	4.4	2.5
2016	17	3.9	2.2
2017	33	5.1	3.0
2018	56	2.5	1.1
2019	60	3.7	2.3
2020	57	5.6	3.0
2021	61	3.6	2.0

The relationship between independent board members and company performance exhibits conflicting findings, with studies showcasing both positive correlations and instances where a higher proportion of independent board members negatively affects company performance. Similarly, the economic studies of state-owned enterprises portray diverse perspectives, with some research emphasizing the importance of effective governance while others highlight the lag in governance improvements. The discrepancies and contextual nuances within these findings warrant further research to elucidate the intricacies of the relationships between independent board members and state-owned enterprise performance.

Therefore, the objective of this study is to examine the relationship between the share of independent members on the board and the financial return of state-owned enterprises.

2. METHODOLOGY

2.1. Research setting and data sample

Following the objective of this study, Lithuania was selected for the empirical research. State-owned enterprises that had functioned independently as standalone companies for a minimum of 4 years within the period from 2015 to 2021 were exclusively selected. As a result, the research sample consisted of 27 state-owned enterprises, with 24 fully operational as standalone companies for the entire research period from 2015 to 2021.

Quantitative and qualitative analysis was applied to present reasonable and comprehensively evaluated research conclusions. Quantitative analysis was used to determine the relationship and trends of variables, while qualitative analysis was used to determine the validity and causality of quantitative research results.

2.2. Independent variable

The share of independent board members is designated as the independent variable. The precise share of independent members on the board of each state-owned enterprise is computed for each year separately, dividing the number of independent board members by the total board size and expressing it in percentage terms.

In this study, the official data on the board members' independence status as reported by the state-owned enterprises and/or Governance Coordination Center were utilized, refraining from questioning or independently verifying the official data on the independence status of any of the board members.

The board size for each specific state-owned enterprise is determined by the bylaws governing that state-owned enterprise. However, it is worth noting that not all board seats are always occupied. In this analysis, only the number of filled seats on the board is considered to calculate the total size of the board.

2.3. Dependent variables

The Lithuanian government aspires to augment the value of its assets within state-owned enterprises, encompassing objectives related to ROA, ROE, and profit contributions (Governance Coordination Center, 2018). Financial return expectations for individual state-owned enterprises are officially endorsed for three-year intervals by the Government of Lithuania. Consequently, two accounting-based indicators of financial return – ROA and ROE – were chosen for examination.

The values of the financial indicators, namely ROA and ROE, are derived directly from the official audited annual reports and/or annual state-owned enterprise reports provided by the state-owned enterprises and prepared by the Governance Coordination Center. In this analysis, the official data are not questioned, double-checked, or recalculated. The ROA and ROE data are expressed as percentages.

2.4. Limitation of statistical analysis

Statistical analysis to establish causal relationships requires large amounts of data. Correlational analysis requires at least twenty data rows of retrospective data to look for a relationship. Establishing causality requires a large amount of parallel data from which dependent and independent variables can be selected. State-owned enterprises publicly publish very limited amounts of data, which is limited to financial statements – balance sheets and profit and loss statements. These documents do not provide the opportunity to see sector-specific information, allowing calculations and conclusions to be made in establishing causal relationships.

Thus, study limitations dictate that causal relationships cannot be established, and correlational analysis from 7 retrospective time series will have lower reliability.

2.5. Qualitative analysis

Qualitative research was used to evaluate and explain the results of the statistical study. The decision to conduct a qualitative study arose when the results of the statistical study were obtained. The statistical study results contradicted the statements found in the literature analysis. To explain the paradox, a deeper case analysis is necessary when the statistical study of a specific case contradicts the prevailing theoretical paradigm and the works of other authors. Deeper analysis can be done by additionally entering more statistical data and more dependent and independent variables, but in this case, the data are of limited use and were not available to the current research. Publicly published state-owned enterprise reports provide limited data that do not reveal the reasons for the paradox. The way to discover the reasons for the paradox is through qualitative research, where people inside the companies, in this case, board members, provide explanations.

To form a sample for a qualitative study, a random targeted sampling was applied, where only a few units were selected in accordance with the principle of randomness, and a small sample was formed. This aims to choose a smaller sample, identify more diverse aspects of experience, and supplement quantitative research data with causal relationships, thus forming deeper insights in the context of the analyzed object. Respondents agreed to be interviewed on the condition that they remain anonymous and that the interviewed company will not be revealed.

The research respondents were randomly selected board members who participated in the activities of the boards of companies operating in the sector of public infrastructure, including such subsectors as public utilities, engineering, and transportation. A semi-structured interview method was applied to provide the interviewees with additional insights that seemed relevant to them. The selected 8 respondents who represented 8 companies had two main characteristics: they had experience as independent board members for at least three years and had at least five years of management experience. The median number of data collection events required to reach 80% saturation is 8 (Namey et al., 2016) for such a qualitative survey, and this is a sufficient number in the case of this particular study because only two questions were established. The questions were formulated by presenting the paradox identified during the statistical analysis. The respondents were asked to explain what goals are set for the board members, according to what the board members are evaluated, and what company performance indicators are used to evaluate the work of the board members. The board members were asked to answer questions in the specific case of the company they represent and as experts in the field in the general situation with Lithuanian state-owned enterprises.

3. RESULTS

3.1. Statistical analysis

The empirical research design generated 183 observations for each variable studied: the share of independent board members, ROA, and ROE (see

http://dx.doi.org/10.21511/ppm.22(1).2024.18

Table 3). The average board size in the sample was 4.51 (SD = 1.37), with 2.22 (SD = 1.28) board members being independent, constituting approximately 47.96% of independent board members on boards in the sample. The mean ROA for state-owned enterprises in the sample was 4.10% (SD = 6.12%), while the mean ROE was 6.44% (SD = 13.79%). It is pertinent to highlight that the SD for both ROA and ROE surpass their corresponding means, signifying a substantial level of heterogeneity in the performance of the companies in the sample throughout the research period.

Table 3. Descriptive statistics

Indicator	Mean	SD	N
Board size	4.51	1.37	183
Independent board members	2.22	1.28	183
Share of independent board members	47.96%	24.46%	183
ROE	6.44%	13.79%	183
ROA	4.10%	6.12%	183

In order to assess the linear relationship between the share of independent board members and both ROA and ROE, respectively, a Pearson correlation coefficient was calculated (see Table 4). In the analysis, no statistically significant positive correlation between the share of independent board members and ROA (r (181) = –0.020, $p > 0.05$) or the share of independent board members and ROE ($r(181) = –0.104$, $p > 0.05$) was found. Interestingly, the correlation between the share of independent board members and ROA and ROE was negative. The fact that there is a negative correlation basically contradicts the statements found in the literature and the generally formed theoretical position that the OECD relies on to promote independent board members.

The independent variable, "share of independent board members," was regressed on predicting the dependent variables ROA and ROE, respectively (see Table 5). The results indicated that the share of independent board members did not significantly predict ROA (F (1, 181) = 0.074, $p > 0.05$) nor ROE ($F(1, 181) = 1.978$, $p > 0.05$).

3.2. Qualitative analysis

The qualitative analysis uncovered that the lack of correlation between independent board members and financial indicators of state-owned enterprises can be explained and determined by several essential factors.

One of the most important goals that the shareholders set for the boards is the transparency of the state-owned enterprises. The aim was to eliminate corruption and nepotism in state-owned enterprises. Ensuring transparency in public procurement is also a crucial aspect. The board members paid enough attention to these aspects to ensure transparency in state-owned enterprises' activities. The board members emphasized that both they in their companies and their colleagues in the public space communicate transparency as one of the greatest values the concept of independent board members has brought to state-owned enterprises.

Another aspect is that the objectives set for the independent members of the boards are usually

Table 4. Inter-item correlation matrix for the relationship between the share of independent board members and state-owned enterprise return

Variable	1	2	3
1. Share of independent board members	1.000	–	–
2. ROE	–0.104	1.000	–
3. ROA	–0.020	0.653*	1.000

Note: * indicates significance at the 0.01 level.

Table 5. Linear regression analysis for the relationship between the share of independent board members and state-owned enterprise return

Regression weights	Beta coefficient	95% confidence interval for B		R squire	F	p-value
		Lower bound	Upper bound			
Independent board members → ROA	–0.005	–0.042	0.032	0.000	0.074	0.787
Independent board members → ROE	–0.059	–0.141	0.024	0.011	1.978	0.161

related to ensuring the well-being of the employees or the general reorganization and optimization of processes. These are more related to internal changes that may not have an impact on financial indicators in the short term and may not have been reflected in the statistics during the analyzed period. The board members aimed to attract as many experienced managers and specialists from the private sector to state-owned enterprises as possible. Board members focused on creating a competitive salary system and good employee working conditions.

Particular state-owned enterprises had different performance indicators, but board members noted that in most cases, balanced scoreboard indicator systems were used, in which the financial aspects of the company's performance were only one of the few indicators.

Among the financial indicators, the company's income and profit were usually used, but ROE or ROA were rarely used. The board meetings usually discuss issues related to the company's investments, public procurement, and pricing. A critical aspect is that all state-owned enterprises operate either in regulated competition with private sector companies or are natural monopolies. Some state-owned enterprises, such as airports, have to compete with foreign markets, but some are pure monopolies providing services to the local population. Despite independent board members, the price in monopolistic companies is determined by political decisions. In Lithuania, state regulators check and approve pricing, but the main focus is on justifying the price with costs and justifying the necessity of costs.

The paradox of why, despite the increase in the proportion of independent board members, ROA and ROE indicators are worsening can also be explained by the fact that companies began to invest more in infrastructure when the Lithuanian economy began to grow after the 2008 financial crisis.

Many investments came from European Union funds, but co-financing required the companies' own contribution. State-owned enterprises had to borrow from banks to co-finance infrastructure development and their own contribution. To achieve better lending ratings and conditions, an important indicator that banks evaluated was the value of the property. In fact, state-owned enterprises own many assets that were not overvalued until then. In the balance sheets, the value of this property was reflected as less than the real value of the property. Many companies have done asset valuations, which has led to an increase in the value of the assets in the financial statements. As the property value increases and investments in the infrastructure of companies increase, but the income and profit of the companies do not grow as much, the return on assets indicators, therefore, decrease.

Another aspect mentioned by the respondents is the strong political position to not increase the prices of public services to users or to provide unprofitable services, so board members have limited opportunities to disagree with common political decisions. The board members emphasized that the indicators of user satisfaction, user availability, the number of failures, and the number of errors are significant in systems of balanced indicators. Many state-owned enterprises carry out the function delegated by the state to provide citizens with transportation, electricity, water, and other necessary aspects of the functioning of the state at an affordable price. This puts state-owned enterprises in a situation where it is tough to ensure the improvement of investment and asset return indicators, as it often conflicts with the implementation of the state function itself.

4. DISCUSSION

The empirical investigation into the association between the share of independent members of the board and the financial return of state-owned enterprises in Lithuania yielded decisive findings. Despite the reforms' objective to enhance state-owned enterprise efficiency through effective governance, specifically by ensuring the inclusion of independent board members and, in turn, increasing asset value and return on assets, this analysis did not reveal significant empirical evidence of a relationship between the proportion of independent board members on boards and state-owned enterprise financial return, as indicated by ROA and ROE, within the Lithuanian context during the period from 2015 to 2021.

Importantly, these findings do not question the suggestion of a significant correlation between state-owned enterprise performance and corporate gover-

http://dx.doi.org/10.21511/ppm.22(1).2024.18

nance (Guan et al., 2021; Heo, 2018) in general since this is not the goal of this study. However, these observations are in contrast to discoveries by Jurkonis et al. (2016), Abang'a et al. (2022), and Hermanto et al. (2021) of a noteworthy positive relationship between state-owned enterprises' financial performance and board composition. More specifically, they contrast a positive relationship between independent members on the board and the financial performance of state-owned enterprises (Abang'a et al., 2022; Cheng & Ng, 2018; M. & Sasidharan, 2020).

Several overarching factors provide an explanatory framework for the findings obtained in this investigation. First, all companies that are established from state property or transferred to the state by the law, which belongs to the state by right of ownership and manage, use, and dispose of the property transferred to it and acquired by it in a fiduciary capacity (Law on State and Municipal Enterprises of the Republic of Lithuania, 2022) in Lithuania are classified as state-owned enterprises. However, the legal status of a state-owned enterprise might be state enterprise, limited liability company, or private limited liability company. There are some differences in governance between different forms of companies that might influence the performance of a state-owned enterprise. Boards at state enterprises have fewer responsibilities and powers than boards at limited liability companies and private limited liability companies. Boards at state enterprises do not approve the company's strategy or key performance indicators, do not appoint a CEO, and do not set a salary and/or motivational system for the CEO. Accordingly, the influence of independent board members and boards in general at state enterprises is very limited. Though since the start of the reforms in Lithuania, state enterprises have been actively converted into either limited liability companies or private limited liability companies, in the sample, 7 state-owned enterprises (26%) still had the legal status of state enterprise.

As of 2018, no more politicians are on the boards of state-owned enterprises in Lithuania. In the sample, more than 50% of board members out of a total mean board size of 4.5 are classified as dependent. Generally, dependent board members are civil servants at corresponding ministries that implement the owner's rights of state-owned enterprises. Though not treated as politicians, civil servants directly or indirectly report to ministers who are politicians. Accordingly, it could be argued that civil servants representing ministries on boards of state-owned enterprises are politically influenced. Boubakri et al. (2008), Menozzi et al. (2012), Kuzman et al. (2018), and Wasowska and Postula (2018) observe that board members' political connections have a detrimental relationship with state-owned enterprise performance.

The independent board members of Lithuanian state-owned enterprises are selected through a public competitive process conducted by the corresponding ministry officials, with the minister signing the final decision. In the last few years, professional independent executive search companies must be involved in organizing the competitive procedure according to the law. Also, the Governance Coordination Center has a representative on the selection committee. Nonetheless, the appointment process of independent board members has a high risk of being influenced politically. Additionally, political influence is a risk to the actual performance of the board since boards of state-owned enterprises report to ministers directly. For example, in 2017, the board of Lithuanian Post, including 4 independent board members out of 5 board members, resigned because of a dispute with the Minister of Transport and Communications.

Some state-owned enterprises in Lithuania provide non-commercial functions by law: services or products that are requisite for society but are loss-making for the state-owned enterprises. For example, Lithuanian Railways transports passengers on specific unprofitable routes, and Lithuanian Post provides financially unprofitable delivery services for subscription publications in remote rural areas. As of 2021, 23 out of 47 state-owned enterprises in Lithuania were legally obliged to carry out non-commercial functions. Though, in theory, state-owned enterprises shall be compensated for non-commercial functions, these functions are considered a limitation in achieving ROE and ROA targets. Accordingly, the influence of independent board members and boards in general on state-owned enterprise performance is limited.

During the qualitative study, additional attention was drawn to the fact that the activities and results of state-owned enterprises are highly dependent on the political situation and changes or reforms carried out by the central government. They, in one way or another, directly affect strategic plans, goals, key performance indicators, and investment directions, considering that independent board members have little opportunity to act or influence decisions determined by national agendas. Therefore, these correlations may have more influence on financial indicators than the number of independent board members and boards in general on state-owned enterprises.

Only in 2018 did the share of independent board members on the boards of Lithuanian state-owned enterprises reach 50%. Since, according to the law, board decisions can only be approved by a majority vote or even 2/3 vote, it implies that the influence of independent board members in many state-owned enterprises was limited, at least until 2018. Following this logic, one would expect different performance results of state-owned enterprises in the sample starting from 2018, but because of the COVID-19 pandemic, state-owned enterprises, like any other companies, had to make decisions not necessarily based on economic logic.

CONCLUSION

The purpose of this study was to examine the relationship between the share of independent members on the board and the financial return of state-owned enterprises. It indirectly explored the premises set forth by the OECD concerning the significance of including independent board members in state-owned enterprise governance while also utilizing the case of Lithuania as an illustrative example of state-owned enterprise governance reform.

Based on the data from 27 Lithuanian state-owned enterprises between 2015 and 2021, this study found no significant link between independent board members and these enterprises' financial performance (ROA and ROE). Therefore, more than the mere presence of independent board members is needed to guarantee improved performance. Accordingly, management practitioners and government officials must acknowledge that the appointment of independent board members alone may not inherently result in a significant enhancement of the financial performance of state-owned enterprises.

Factors such as legal status, national agenda, and regulations also significantly influence outcomes. Some state-owned enterprises in Lithuania have a limited board role due to their state enterprise status, hindering involvement in crucial decisions like strategy approval and CEO appointment. Mandated non-commercial functions by law obstruct achieving financial targets. Additionally, board decisions, often requiring a majority or 2/3 votes, may introduce political influences, especially if independent board members are in the minority. The selection process for independent board members, done through a public competitive route and reporting to ministries, raises concerns about alignment with ministerial expectations over the enterprises' best interests.

AUTHOR CONTRIBUTIONS

Conceptualization: Donatas Voveris, Andrius Jaržemskis, Ieva Girdvainienė.
Data curation: Donatas Voveris.
Formal analysis: Donatas Voveris.
Investigation: Donatas Voveris.
Methodology: Donatas Voveris, Andrius Jaržemskis, Ieva Girdvainienė.
Resources: Donatas Voveris, Andrius Jaržemskis, Ieva Girdvainienė.
Supervision: Andrius Jaržemskis.
Validation: Andrius Jaržemskis.
Writing – original draft: Donatas Voveris, Andrius Jaržemskis, Ieva Girdvainienė.
Writing – review & editing: Andrius Jaržemskis.

http://dx.doi.org/10.21511/ppm.22(1).2024.18

REFERENCES

1. Abang'a, A. O., Tauringana, V., Wang'ombe, D., & Achiro, L. O. (2022). Corporate governance and financial performance of state-owned enterprises in Kenya. *Corporate Governance: The International Journal of Business in Society, 22*(4), 798-820. https://doi.org/10.1108/CG-01-2021-0007
2. Al-Saidi, M. (2021). Board independence and firm performance: Evidence from Kuwait. *International Journal of Law and Management, 63*(2), 251-262. https://doi.org/10.1108/IJLMA-06-2019-0145
3. Bøhren, Ø., & Staubo, S. (2016). Mandatory gender balance and board independence. *European Financial Management, 22*(1), 3-30. https://doi.org/10.1111/eufm.12060
4. Boubakri, N., Cosset, J.-C., & Saffar, W. (2008). Political connections of newly privatized firms. *Journal of Corporate Finance, 14*(5), 654-673. https://doi.org/10.1016/j.jcorpfin.2008.08.003
5. Böwer, U. (2017). State-owned enterprises in emerging Europe: The good, the bad, and the ugly. *IMF Working Papers, 2017*(221). https://doi.org/10.5089/9781484315163.001
6. Bozec, R., & Dia, M. (2007). Board structure and firm technical efficiency: Evidence from Canadian state-owned enterprises. *European Journal of Operational Research, 177*(3), 1734-1750. https://doi.org/10.1016/j.ejor.2005.10.001
7. Cheng, Q., & Ng, A. (2018). State ownership, governance and financial performance of Chinese state owned enterprises. *Journal of Accounting, 8*(1). Retrieved from https://zantworldpress.com/wp-content/uploads/2020/06/4.-Alex-and-Quang.pdf
8. Curi, C., Gedvilas, J., & Lozano-Vivas, A. (2016). Corporate governance of SOEs and performance in transition countries. Evidence from Lithuania. *Modern Economy, 7*(12). http://dx.doi.org/10.4236/me.2016.712126
9. Fuzi, S. F. S., Halim, S. A. A., & Julizaerma, M. K. (2016). Board independence and firm performance. *Procedia Economics and Finance, 37,* 460-465. https://doi.org/10.1016/S2212-5671(16)30152-6
10. Gani, L., & Jermias, J. (2006). Investigating the effect of board independence on performance across different strategies. *The International Journal of Accounting, 41*(3), 295-314. https://doi.org/10.1016/j.intacc.2006.07.009
11. Governance Coordination Center (GCC). (2011). *State-owned enterprises in Lithuania: Annual report 2010*. Retrieved from https://governance.lt/wp-content/uploads/2018/09/2010_metine.pdf
12. Governance Coordination Center (GCC). (2016). *State-owned enterprises in Lithuania: Annual report 2015*. Retrieved from https://governance.lt/wp-content/uploads/2018/09/VKC_2016_LT_A4_WEB.pdf
13. Governance Coordination Center (GCC). (2018). *State-owned enterprises in Lithuania: Annual report 2017*. Retrieved from https://governance.lt/wp-content/uploads/2018/09/SOE_Report_2018_EN_WEB.pdf
14. Governance Coordination Center (GCC). (2022). *State-owned enterprises in Lithuania: Annual report 2021/2022*. Retrieved from https://governance.lt/wp-content/uploads/2022/11/VKC-VVI-Metine-Ataskaita_2022_LT_WEB_NEW.pdf
15. Guan, J., Gao, Z., Tan, J., Sun, W., & Shi, F. (2021). Does the mixed ownership reform work? Influence of board chair on performance of state-owned enterprises. *Journal of Business Research, 122*, 51-59. https://doi.org/10.1016/j.jbusres.2020.08.038
16. Heo, K. (2018). *Effects of corporate governance on the performance of state-owned enterprises* (World Bank Policy Research Working Paper No. 8555). Washington, DC: The World Bank. Retrieved from https://openknowledge.worldbank.org/handle/10986/30282
17. Hermanto, Y. B., Lusy, L., & Widyastuti, M. (2021). How financial performance and state-owned enterprise (SOE) values are affected by good corporate governance and intellectual capital perspectives. *Economies, 9*(4), 134. https://doi.org/10.3390/economies9040134
18. Hoitash, U. (2011). Should independent board members with social ties to management disqualify themselves from serving on the board? *Journal of Business Ethics, 99*(3), 399-423. https://doi.org/10.1007/s10551-010-0660-5
19. Huse, M. (1994). Board-management relations in small firms: The paradox of simultaneous independence and interdependence. *Small Business Economics, 6*(1), 55-72. https://doi.org/10.1007/BF01066112
20. Ilham, R. N., Arliansyah, A., Juanda, R., Sinta, I., Multazam, M., & Syahputri, L. (2022). Application of good corporate governance principles in improving benefits of state-owned enterprises (An emperical evidence from Indonesian Stock Exchange at moment of Covid-19). *International Journal of Economic, Business, Accounting, Agriculture Management and Sharia Administration (IJEBAS), 2*(5), 761-772. Retrieved from https://radjapublika.com/index.php/IJEBAS/article/view/410
21. Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, *3*(4), 305-360. https://doi.org/10.1016/0304-405X(76)90026-X
22. Jurkonis, L., & Aničas, I. (2015). Impact of the board on management of Lithuanian state owned enterprises. *Ekonomika, 94*(3), 139-151. http://dx.doi.org/10.15388/Ekon.2015.3.8792
23. Jurkonis, L., Merkliopas, Š., & Kyga, K. (2016). Impact of the corporate governance reform on the management effectiveness of state-owned enterprises in Lithuania in 2012–2014. *Ekonomika, 95*(2),

158-178. https://doi.org/10.15388/Ekon.2016.2.10130

24. Kanakriyah, R. (2021). The impact of board of directors' characteristics on firm performance: A case study in Jordan. *The Journal of Asian Finance, Economics and Business, 8*(3), 341-350. https://doi.org/10.13106/jafeb.2021.vol8.no3.0341
25. Kloviene, R., Gimzauskiene, E., & Misiunas, D. (2015). The significance of SOEs performance measurement as policy instrument in Baltic countries. *Procedia – Social and Behavioral Sciences, 213,* 286-292. https://doi.org/10.1016/j.sbspro.2015.11.539
26. Koerniadi, H., & Tourani-Rad, A. (2012). Does board independence matter? Evidence from New Zealand. *Australasian Accounting, Business and Finance Journal, 6*(2), 3-18. Retrieved from https://ro.uow.edu.au/cgi/viewcontent.cgi?article=1334&context=aabfj
27. Kumar, M. V. S., Nagarajan, N. J., & Schlingemann, F. P. (2021). The performance of acquisitions of founder CEO firms: The effect of founder firm premium. *Strategic Entrepreneurship Journal, 15*(4), 619-646. https://doi.org/10.1002/sej.1371
28. Kuzman, T., Talavera, O., & Bellos, S. K. (2018). Politically induced board turnover, ownership arrangements, and performance of SOEs. *Corporate Governance: An International Review, 26*(3), 160-179. https://doi.org/10.1111/corg.12238
29. Lefort, F., & Urzúa, F. (2008). Board independence, firm performance and ownership concentration: Evidence from Chile. *Journal of Business Research, 61*(6), 615-622. https://doi.org/10.1016/j.jbusres.2007.06.036
30. Leung, S., Richardson, G., & Jaggi, B. (2014). Corporate board and board committee independence, firm performance, and family ownership concentration: An analysis based on Hong Kong firms. *Journal of Contemporary Accounting & Economics, 10*(1), 16-31. https://doi.org/10.1016/j.jcae.2013.11.002
31. Liu, Y., Miletkov, M. K., Wei, Z., & Yang, T. (2015). Board independence and firm performance in China. *Journal of Corporate Finance, 30,* 223-244. https://doi.org/10.1016/j.jcorpfin.2014.12.004
32. M., T., & Sasidharan, A. (2020). Does board independence enhance firm value of state-owned enterprises? Evidence from India and China. *European Business Review, 32*(5), 785-800. https://doi.org/10.1108/EBR-09-2019-0224
33. Menozzi, A., Gutiérrez Urtiaga, M., & Vannoni, D. (2012). Board composition, political connections, and performance in state-owned enterprises. *Industrial and Corporate Change, 21*(3), 671-698. https://doi.org/10.1093/icc/dtr055
34. Musleh Alsartawi, A. (2019). Board independence, frequency of meetings and performance. *Journal of Islamic Marketing, 10*(1), 290-303. https://doi.org/10.1108/JIMA-01-2018-0017
35. Namey, E., Guest, G., McKenna, K., & Chen, M. (2016). Evaluating bang for the buck: A cost-effectiveness comparison between individual interviews and focus groups based on thematic saturation levels. *American Journal of Evaluation, 37*(3), 425-440. https://doi.org/10.1177/1098214016630406
36. OECD. (2015). *G20/OECD principles of corporate governance*. Paris: OECD Publishing. Retrieved from https://www.oecd-ilibrary.org/governance/g20-oecd-principles-of-corporate-governance-2015_9789264236882-en
37. OECD. (2022). *Note by the OECD Secretariat on Lithuania's implementation of corporate governance accession review recommendations* (DAF/CA/CG/ACS(2022)4/FINAL). Organisation for Economic Co-operation and Development. Retrieved from https://eimin.lrv.lt/uploads/eimin/documents/files/OECD-Note2022-Lithuania-implementation-corporate-governance-accession-review-recommendations.pdf
38. Okhmatovskiy, I., Grosman, A., & Sun, P. (2022). Hybrid governance of state-owned enterprises. In M. Wright, G. T. Wood, A. Cuervo-Cazurra, P. Sun, I. Okhmatovskiy, & A. Grosman (Eds.), *Oxford Handbook of State Capitalism and the Firm* (pp. 449-478). Oxford: Oxford University Press. http://dx.doi.org/10.1093/oxfordhb/9780198837367.013.20
39. Ramdani, D., & van Witteloostuijn, A. (2010). The impact of board independence and CEO duality on firm performance: A quantile regression analysis for Indonesia, Malaysia, South Korea and Thailand. *British Journal of Management, 21*(3), 607-627. https://doi.org/10.1111/j.1467-8551.2010.00708.x
40. Rutledge, R. W., Karim, K. E., & Lu, S. (2016). The effects of board independence and CEO duality on firm performance: Evidence from the NASDAQ-100 Index with controls for endogeneity. *Journal of Applied Business & Economics, 18*(2). Retrieved from https://articlegateway.com/index.php/JABE/article/view/838
41. Ryan Jr., H. E., & Wiggins III, R. A. (2004). Who is in whose pocket? Director compensation, board independence, and barriers to effective monitoring. *Journal of Financial Economics, 73*(3), 497-524. https://doi.org/10.1016/j.jfineco.2003.11.002
42. Seimas of the Republic of Lithuania. (2022, December 22). *Lietuvos Respublikos valstybės ir savivaldybės įmonių įstatymas [Law on state and municipal enterprises of the Republic of Lithuania].* (In Lithuanian). Retrieved from https://www.e-tar.lt/portal/lt/legalAct/TAR.29FB2C8807FE/ecqkybQisf
43. Shan, Y. G. (2019). Managerial ownership, board independence and firm performance. *Accounting Research Journal, 32*(2), 203-220. https://doi.org/10.1108/ARJ-09-2017-0149
44. Simpson, S. N. Y. (2014). Boards and governance of state-owned enterprises. *Corporate Governance, 14*(2), 238-251. https://doi.org/10.1108/CG-08-2012-0063

http://dx.doi.org/10.21511/ppm.22(1).2024.18

45. Singhchawla, W., Evans, R., & Evans, J. (2011). Board independence, sub-committee independence and firm performance: Evidence from Australia. *Asia Pacific Journal of Economics & Business, 15*(2), 1-15. Retrieved from https://espace.curtin.edu.au/bitstream/handle/20.500.11937/8620/182975_55370_Asia_Pacific_Journal_2011.pdf?sequence=2

46. Souther, M. E. (2021). Does board independence increase firm value? Evidence from closed-end funds. *Journal of Financial and Quantitative Analysis, 56*(1), 313-336. https://doi.org/10.1017/S0022109019000929

47. Uribe-Bohorquez, M.-V., Martínez-Ferrero, J., & García-Sánchez, I.-M. (2018). Board independence and firm performance: The moderating effect of institutional context. *Journal of Business Research, 88,* 28-43. https://doi.org/10.1016/j.jbusres.2018.03.005

48. Wagner, A. F. (2011). Board independence and competence. *Journal of Financial Intermediation, 20*(1), 71-93. https://doi.org/10.1016/j.jfi.2010.06.002

49. Wasowska, A., & Postula, I. (2018). Formal and informal governance mechanisms in state-owned enterprises: Evidence from post-transitional Poland. *Baltic Journal of Management, 13*(4), 410-432. https://doi.org/10.1108/BJM-06-2017-0172

50. Wong, S. C. Y. (2018). *The state of governance at state-owned enterprises* (Public Sector Opinion No. 40). Washington, DC: International Finance Corporation. https://doi.org/10.1596/29533