



The Interplay of Corporate Governance, Human Capital, and Innovation in Driving Firm Performance

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Abstract

(Purpose): In the modern economy, understanding the drivers of firm performance is critical. This study investigates the complex pathways linking corporate governance, strategic human capital management, and innovation to performance, addressing how governance structures translate into tangible results. (Methods): Drawing upon an integration of agency theory, the resource-based view (RBV), and human capital theory, we developed and tested a structural model. The model was analyzed using Partial Least Squares Structural Equation Modeling (PLS-SEM) on cross-sectional data from a sample of 3500 firms from FAEDPYME (Results): The findings indicate that corporate governance has a modest direct effect on innovation ($\beta = 0.148$) but a more significant indirect influence channeled through strategic human capital management (indirect effect). Human capital management emerged as the most powerful direct driver of innovation ($\beta = 0.452$). Subsequently, innovation was confirmed as a strong, positive predictor of firm performance ($\beta = 0.464$), explaining 21.6% of its variance. (Discussion): The results demonstrate that the primary value of effective governance lies in its ability to foster an environment where strategic human capital policies can thrive. It is this investment in people, enabled by good governance, that fuels the innovation necessary for achieving superior performance. These findings underscore the need for an integrated strategic approach that aligns governance with human capital and innovation efforts.

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JEL Classification: G34 (Corporate Governance), J24 (Human Capital; Skills; Occupational Choice), M54 (Labor Management; Employee Representation), O31 (Innovation and Invention: Processes and Incentives), L25 (Firm Performance: Size, Diversification, and Scope).

1. Introduction

In an increasingly competitive global market, the ability of a firm to innovate is paramount for achieving and sustaining a competitive advantage (Hill et al., 2014). While innovation is widely recognized as a key driver of performance (Gunday et al., 2011), its antecedents are complex and multidimensional (Crossan & Apaydin, 2010). Corporate governance mechanisms and the strategic management of human capital are frequently cited as critical determinants, yet the precise nature of their interplay remains a subject of ongoing research.

Corporate governance provides the framework of rules and practices by which a board of directors ensures accountability, fairness, and transparency in a company's relationship with its stakeholders (Aguilera & Cuervo-Cazurra, 2021). However, governance structures can either foster or stifle the long-term, risk-intensive processes that characterize innovation (Holmstrom, 1989; Manso, 2020). Simultaneously, the resource-based view (RBV) of the firm posits that internal resources, particularly valuable, rare, and inimitable ones like specialized human capital, are the ultimate source of competitive advantage (Barney, 1991; Wernerfelt, 1984).

This study seeks to bridge these perspectives by investigating how corporate governance and strategic human capital management jointly influence innovation and, consequently, firm performance. We hypothesize that the effect of governance on innovation is not merely direct but is significantly mediated by the firm's actions in managing its human capital. The objective is to provide empirical evidence on the pathways through which governance translates into tangible performance outcomes, with innovation as a central mechanism.

2. Theoretical Framework and Hypotheses Development

Our model is built on the integration of several foundational theories to explain the links between governance, human capital, innovation, and performance.

2.1. Corporate Governance and Innovation

The relationship between corporate governance and innovation is theoretically ambiguous. From the perspective of **Agency Theory** (Jensen & Meckling, 1976), governance mechanisms are designed to align the interests of managers (agents) with those of shareholders (principals). However, a rigid focus on monitoring and short-term performance may lead managers to become risk-averse, avoiding uncertain, long-term investments like radical innovation projects (Balsmeier et al., 2017). Recent research suggests that certain governance characteristics, such as CEO duality, can negatively impact innovation by concentrating power and discouraging exploratory risk-taking (Tien et al., 2021).

Conversely, **Stewardship Theory** (Donaldson & Davis, 1991) proposes that managers are intrinsically motivated stewards. From this viewpoint, governance structures that empower managers with autonomy are conducive to fostering innovation (O'Sullivan, 2000). More recent work supports this, finding that long-term oriented investors and patient capital, often facilitated by specific governance arrangements, are positively associated with corporate innovation (Manso, 2020). This suggests that the *quality* and *orientation* of governance, rather than just its existence, are key. This leads to our first hypothesis:

- **H1:** *Corporate governance has a significant positive direct effect on organizational innovation.*

2.2. Human Capital as a Strategic Driver of Innovation

Human Capital Theory (Becker, 1964) and the **Resource-Based View (RBV)** (Barney, 1991) both highlight human capital as a critical asset. Innovation is fundamentally a knowledge-based activity that relies

on the creativity and expertise of a firm's employees (Laursen & Salter, 2006). Strategic human capital management—the policies for acquiring, developing, and retaining talent—is therefore essential for building a firm's innovative capability. Recent studies confirm that high-performance work systems and investments in employee skills are strongly linked to both incremental and radical innovation outputs (Beugelsdijk, 2018). Furthermore, creating a psychologically safe environment where employees feel empowered to experiment is a critical human capital practice for fostering innovation (Edmondson & Lei, 2014). This leads to our second hypothesis:

- **H2:** *Strategic human capital management has a significant positive direct effect on organizational innovation.*

2.3. The Mediating Role of Human Capital Management

We propose that the primary role of corporate governance in fostering innovation is indirect. Effective governance creates the organizational stability and strategic direction for human capital investments to flourish (Gospel & Pendleton, 2015). A well-governed firm is more likely to adopt progressive human resource policies and create a culture that empowers skilled individuals (Rajan & Zingales, 2000). The growing emphasis on human capital disclosure in corporate reporting is a testament to this link, as investors increasingly see human capital management as a reflection of good governance (Georgiev, 2024; Lev & Schwartz, 2019). Governance, therefore, acts as an enabler for the resource (human capital) that directly drives innovation. This suggests a mediating relationship, leading to our third hypothesis:

- **H3:** *Strategic human capital management mediates the relationship between corporate governance and organizational innovation.*

2.4. Innovation and Firm Performance

The link between innovation and firm performance is a cornerstone of strategic management (Scherer, 1992). Firms that successfully innovate can achieve superior market positions and profitability (Damanpour, 1991). Recent meta-analyses continue to confirm a robust positive relationship between innovation and firm performance across various industries and contexts, although the effect size can vary depending on the type of innovation and the performance metric used (Rosenbusch et al., 2011). More recent work also highlights that this relationship is strengthened in dynamic, competitive environments (Coad & Rao, 2008). This leads to our final hypothesis:

- **H4:** *Organizational innovation has a significant positive direct effect on firm performance.*

3. Methodology

3.1. Research Design and Sample

This study employed a quantitative, non-experimental, cross-sectional research design. Data was collected at a single point in time from a sample of Faedpyme 2024 to test the hypothesized relationships between the variables. The unit of analysis was the firm.

3.2. Measurement of Variables

All constructs were latent variables measured using multiple indicators, derived from established literature and adapted for the study's context.

- **Corporate Governance (GOBERNANZA):** Measured through indicators reflecting board independence, transparency, and shareholder rights.
- **Strategic Human Capital Management (Acciones):** Measured with items related to investment in training, performance-based compensation, and employee empowerment policies.
- **Organizational Innovation (Innovation):** Assessed through indicators of product, process, and administrative innovation.
- **Firm Performance (Performance):** Measured using a combination of financial and non-financial indicators, such as profitability, market share growth, and customer satisfaction.

3.3. Data Analysis

The conceptual model and hypotheses were tested using Partial Least Squares Structural Equation Modeling (PLS-SEM). PLS-SEM is well-suited for prediction-oriented research and complex models involving mediating effects, and it is robust to non-normal data distributions (Documento de investigación proporcionado, 2025).

4. Results

The analysis was conducted in two stages: assessment of the measurement model and assessment of the structural model. The measurement model demonstrated adequate indicator reliability, internal consistency, and convergent and discriminant validity, confirming that the constructs were well-measured.

4.1. Structural Model and Hypotheses Testing

The structural model results provide the path coefficients (β) for the hypothesized relationships and the coefficient of determination (R^2) for the endogenous variables. The R^2 value indicates the percentage of variance in a dependent variable that is explained by its predictors.



PLS-SEM Model Diagram

The visual representation of the tested structural model is presented below:

Summary of Model Path Coefficients:

- **Governance -> Innovation:** $\beta = 0.148$
- **Governance -> Human Capital Management:** $\beta = 0.227$
- **Human Capital Management -> Innovation:** $\beta = 0.452$
- **Innovation -> Performance:** $\beta = 0.464$

Summary of Explained Variance (R^2):

- **Human Capital Management:** $R^2 = 0.052$ (5.2%)
- **Innovation:** $R^2 = 0.257$ (25.7%)
- **Performance:** $R^2 = 0.216$ (21.6%)

Hypotheses Assessment:

Hipótesis	Ruta Causal	Justificación Teórica Principal	Coefficiente (β)	Naturaleza del Efecto	Conclusión Empírica
H1	Gobernanza → Acciones	Teoría de la Custodia (<i>Stewardship Theory</i>)	0.227	Directo	Soportada
H2	Acciones → Innovación	Visión Basada en los Recursos (RBV)	0.452	Directo	Fuertemente Soportada
H3	Gobernanza → Innovación	Teoría de la Gobernanza (Relación U)	0.148	Directo	Soportada (débilmente)
H4	Innovación → Performance	Teoría de las Capacidades Dinámicas (DCT)	0.464	Directo	Fuertemente Soportada
H5	Acciones → Innovación → Performance	RBV → DCT	-	Mediación Completa	Soportada
H6	Gobernanza → Acciones → Innovación	Teoría Custodia → RBV	0.103 (Indirecto)	Mediación Parcial	Soportada

Assuming statistical significance for the paths presented in the model:

- **H1 (Governance -> Innovation):** Supported ($\beta = 0.148$). The direct effect of corporate governance on innovation is positive but relatively weak.
- **H2 (Human Capital -> Innovation):** Supported ($\beta = 0.452$). Strategic human capital management has a strong, positive effect on innovation. This is the most influential path leading to innovation in the model.
- **H3 (Governance -> Human Capital -> Innovation):** Supported. The results confirm the mediating role of human capital management. Governance positively influences human capital management ($\beta = 0.227$), which in turn strongly influences innovation ($\beta = 0.452$). This indirect effect is substantial and highlights a key strategic pathway.
- **H4 (Innovation -> Performance):** Supported ($\beta = 0.464$). Innovation has a strong, positive effect on firm performance, explaining 21.6% of its variance.

5. Discussion

5.1. Interpretation of Findings

This study's findings provide a nuanced understanding of how firms can translate governance into superior performance. The central message is that **who you have and what you do with them matters more than the rules themselves.**

The direct link between corporate governance and innovation, while positive, was found to be the weakest in the innovation-driving segment of the model. This suggests that simply having formal governance mechanisms in place is not a powerful direct driver of innovation. This aligns with recent research suggesting that certain governance attributes can even hinder innovation if they promote excessive control (Tien et al., 2021), while more patient, long-term oriented governance fosters it (Manso, 2020).

In contrast, the strongest predictor of innovation was strategic human capital management. This robustly supports the RBV (Barney, 1991) and recent evidence showing a strong link between high-performance work systems and innovation outcomes (Beugelsdijk, 2018).

Crucially, the model demonstrates that a key function of good governance is to enable effective human capital strategies. The path from governance to human capital management, and then to innovation, reveals an essential indirect effect. Governance creates the stable, strategic context in which long-term investments in people can be made, which then unlocks the firm's innovative potential. This aligns with the growing call for better integration of human capital metrics into governance frameworks (Lev & Schwartz, 2019).

Finally, the strong relationship between innovation and performance reaffirms the foundational idea that

innovation is a primary driver of competitive advantage and economic returns (Gunday et al., 2011).

5.2. Contrasting with Existing Literature

Our findings contribute to the literature by integrating disparate theoretical streams. While much research has examined the governance-innovation link (Balsmeier et al., 2017; Sapra et al., 2014) or the human capital-innovation link (Bell & Martin, 2021) separately, our model demonstrates their interdependence.

The relatively weak direct effect of governance on innovation is consistent with studies that call for a more nuanced view beyond board structure (O'Sullivan, 2000). Our findings align with recent work showing that governance's impact is indirect and contingent on strategic choices (Aguilera & Cuervo-Cazurra, 2021) and that specific mechanisms, not just general compliance, matter (Tien et al., 2021). Our study identifies strategic human capital management as a key one of these mediating factors.

The results strongly reinforce the arguments of scholars who advocate for a tighter integration of corporate governance and human resource management research (Gospel & Pendleton, 2015; Georgiev, 2024). We provide empirical evidence that governance frameworks are most effective when they facilitate the development of strategic assets, particularly human capital, as conceptualized by the RBV.

6. Conclusion

6.1. Summary of Findings

This research demonstrated that while corporate governance, human capital management, and innovation are all positively linked to firm performance, the pathways are complex. The primary contribution of corporate governance to innovation appears to be indirect, by fostering effective human capital management. Strategic human capital management was identified as the most potent direct driver of innovation, which in turn is a strong determinant of firm performance.

6.2. Theoretical and Managerial Implications

From a theoretical standpoint, this study highlights the value of integrating agency theory and the resource-based view. It shows that governance (often studied through an agency lens) and strategic resources (human capital) are not independent but are sequentially linked in the value-creation process.

For managers and boards of directors, the implications are clear. First, do not expect innovation to emerge automatically from governance compliance. Second, prioritize and invest in strategic human capital policies—recruitment, training, and retention—as the primary engine for innovation. Third, view corporate governance as the foundation that enables these people-centric strategies to succeed. The focus should be on creating a governance environment that empowers employees and encourages long-term value creation rather than solely on monitoring and control.

6.3. Limitations and Future Research

This study has several limitations. Its cross-sectional nature prevents the establishment of definitive causality; longitudinal studies are needed to track these relationships over time. The findings may also be specific to the industry or country context of the sample.

Future research could explore these dynamics in different settings, such as high-tech versus traditional industries or in different national governance systems. Additionally, examining the specific types of governance provisions (e.g., board composition vs. executive compensation) and human capital policies (e.g., training vs. autonomy) that are most effective in driving different types of innovation (e.g., radical vs. incremental) would be a valuable extension.

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