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ETHICAL CORPORATE GOVERNANCE AND INNOVATION PERFORMANCE IN CHINESE MANUFACTURING FIRMS: THE MEDIATING ROLE OF INTERNAL RESOURCE ALLOCATION

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Abstract: *Ethical corporate governance plays an important role in promoting sustainable innovation and responsible managerial decision-making, particularly in the context of technological disruption and industrial transformation. In Chinese manufacturing firms, innovation requires not only financial support but also effective internal resource allocation to sustain long-term competitiveness. However, existing studies have primarily focused on the direct relationship between corporate governance and innovation performance, with limited attention given to the internal managerial processes that connect governance practices with innovation outcomes. Therefore, this study reviews the literature on ethical corporate governance, internal resource allocation, and innovation performance in Chinese manufacturing firms. A narrative literature review approach was adopted, and relevant peer-reviewed studies published in major academic journals were identified through a structured literature search of the Scopus, Web of Science, and Google Scholar databases using predefined keywords related to the research topic. The review examines governance mechanisms, including board independence, CEO duality, board size, and ownership concentration, from ethical governance and management accounting perspectives. This review contributes theoretically by integrating Agency Theory and management accounting perspectives to explain how internal resource allocation functions as a mechanism linking ethical corporate governance with innovation performance. The study also identifies key research gaps and proposes directions for future research, providing a conceptual foundation for advancing governance and innovation research in Chinese manufacturing firms.*

Keywords: *Ethical Corporate Governance; Internal Resource Allocation; Innovation Performance; Management Accounting; Chinese Manufacturing Firms*

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Introduction

Technological disruption and industrial transformation have increased the importance of innovation in manufacturing firms. In Chinese manufacturing firms, innovation activities require not only financial investment but also effective internal resource allocation and long-term planning. Ethical corporate governance has therefore become increasingly important because governance mechanisms influence transparency, accountability, monitoring quality, and strategic decision making. Prior studies suggest that governance mechanisms such as board independence, CEO duality, board size, and ownership concentration influence innovation performance. However, existing findings remain inconsistent. Some studies report positive effects of governance on innovation, while others suggest that excessive monitoring may reduce managerial risk-taking and weaken innovation capability. In addition, many previous studies mainly focus on direct relationships between governance and innovation performance while giving limited attention to internal managerial processes. From a management accounting perspective, internal resource allocation reflects budgeting discipline, investment planning, and capital allocation quality. Therefore, internal resource allocation may function as an important mechanism linking ethical corporate governance with innovation performance.

Drawing on Agency Theory and management accounting perspectives, this review examines how governance mechanisms influence innovation through internal resource allocation. Chinese manufacturing firms are selected because they operate in a unique institutional environment characterized by rapid industrial transformation and ongoing corporate governance reforms. Accordingly, this study addresses two research questions: how ethical corporate governance influences innovation performance and what role internal resource allocation plays in this relationship. The findings provide practical insights for managers and policymakers seeking to strengthen governance practices and promote sustainable innovation. The remainder of this paper reviews the relevant literature, discusses the proposed relationships among the key constructs, and concludes with the study's implications and recommendations for future research.

Literature Review

Innovation Performance

Definition and Evolution of Innovation Performance

The theoretical origins of innovation can be traced to the seminal work of Schumpeter (1934), who identified innovation as the primary driver of economic development. Schumpeter argued that firms achieve competitive advantage through the introduction of new products, new production methods, new markets, new sources of raw materials, and new organizational structures. According to Liu (2025), Schumpeter’s perspective represented a major shift in economic theory because innovation was viewed as an internal strategic activity rather than a passive response to market conditions.

As innovation research developed, scholars expanded the concept of innovation beyond technological change. Zhou and Mei (2025) argued that innovation includes knowledge innovation, technological innovation, and institutional innovation. This broader perspective emphasizes that innovation activities involve not only product development but also

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organizational transformation and managerial improvement. Consequently, scholarly attention gradually shifted toward evaluating the effectiveness and outcomes of innovation activities.

Innovation performance emerged as an important construct for assessing whether innovation activities generate organizational value. Earlier studies often adopted a narrow perspective by focusing on the commercialization success of innovation activities. Xiaonan et al. (2025) noted that this approach primarily emphasized market outcomes and economic returns. However, subsequent research introduced broader definitions incorporating innovation inputs, implementation processes, and final outputs. Forsman (2011) argued that innovation performance should reflect the effectiveness of idea generation, product development, process improvement, and technological acquisition.

Despite these broader perspectives, scholars also identified important conceptual limitations. Khan and Ahmad (2022) argued that process-oriented definitions often blur the distinction between innovation effort and innovation success. Similarly, Hongsheng and Li (2025) noted that process-based indicators are difficult to operationalize in large-sample empirical studies due to measurement subjectivity and limited data availability. As a result, outcome-oriented perspectives gained increasing acceptance in empirical innovation research.

From an outcome perspective, innovation performance reflects realized innovation achievements rather than ongoing activities. Zhaoyuan and Yu (2025) distinguished between R&D innovation performance and market innovation performance, emphasizing that innovation outcomes should be evaluated based on observable results. This perspective is particularly relevant for governance research because governance mechanisms are expected to influence final innovation outcomes through managerial decision processes and investment discipline.

Corporate Governance

Definition of Corporate Governance

Corporate governance is commonly defined as a system of rules, structures, and monitoring mechanisms used to direct and control organizational activities. Governance mechanisms regulate relationships among managers, boards of directors, shareholders, and stakeholders while ensuring accountability and transparency in organizational decision making. Yassin and Al-Okaily (2025) argued that the primary objective of corporate governance is to ensure the efficient and responsible use of organizational resources while reducing conflicts of interest between managers and owners.

The theoretical foundation of corporate governance is closely associated with Agency Theory. Berle and Means (1932) first identified the separation of ownership and control as a major organizational issue in modern corporations. Jensen and Meckling (1976) later formalized this problem through agency theory by emphasizing conflicts arising from managerial opportunism and information asymmetry. Governance mechanisms therefore function as monitoring and control systems designed to align managerial behavior with shareholder interests.

However, prior studies suggest that corporate governance extends beyond monitoring functions. Solomon (2021) argued that governance mechanisms also influence ethical conduct,

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organizational sustainability, and long-term strategic decision making. This broader perspective emphasizes that governance should not only protect shareholder interests but also support responsible managerial behavior and sustainable organizational development.

Corporate Governance in China

Corporate governance in China has developed within a unique institutional environment characterized by state influence, concentrated ownership, and gradual market reform. Although governance reforms have strengthened disclosure requirements and board responsibilities, many Chinese manufacturing firms continue to exhibit concentrated ownership structures involving state entities or family-controlled shareholders. Liu (2022) observed that formal governance reforms coexist with strong political and ownership influence, which may affect the effectiveness of governance mechanisms.

Empirical findings regarding governance effectiveness in China remain inconsistent. Some studies suggest that governance mechanisms improve monitoring quality and reduce agency problems. Other studies indicate that governance structures may function symbolically rather than substantively due to controlling shareholder dominance and political connections. Zhang and Omar (2025) argued that governance effectiveness in China depends heavily on ownership structure, institutional enforcement, and board independence.

This institutional complexity is particularly important in manufacturing firms, where innovation activities require substantial financial commitment and long-term strategic planning. Governance mechanisms may therefore influence innovation outcomes through their effects on investment discipline and internal resource allocation rather than through immediate financial performance.

Board independence is one of the most frequently examined governance mechanisms in prior literature. It is commonly defined as the proportion of independent non-executive directors on the board. Garcia-Sanchez and Martinez-Ferrero (2021) argued that board independence improves governance effectiveness because independent directors strengthen monitoring quality and reduce managerial opportunism. Existing studies generally suggest that independent directors improve transparency, reporting quality, and strategic oversight. Naciti (2020) found that firms with higher board independence demonstrate stronger disclosure quality and lower earnings manipulation. Yu (2023) similarly reported that independent directors improve accounting information quality and governance transparency.

However, empirical findings remain inconsistent, particularly in emerging market environments. Abiad and Ruaa (2025) argued that formal independence does not necessarily imply effective monitoring because independent directors may lack sufficient authority or firm-specific knowledge. Zhang and Omar (2025) further emphasized that independent directors in Chinese firms may be influenced by controlling shareholders or political interests, thereby weakening their monitoring effectiveness. The literature also suggests that board independence influences investment discipline and strategic resource allocation. Omenihu and Chioma (2025) argued that independent directors improve investment evaluation and reduce inefficient investment behavior. Nevertheless, other studies report that independent directors may have limited influence over internal capital allocation decisions when ownership concentration is high.

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CEO duality refers to a governance structure in which the chief executive officer simultaneously serves as the chairperson of the board. Prior studies widely examine CEO duality because leadership concentration directly affects monitoring effectiveness and managerial accountability. From an agency theory perspective, CEO duality weakens board independence and increases the risk of managerial opportunism. Dakhli and Khelil (2025) argued that CEO duality reduces monitoring quality because decision control and managerial authority become concentrated in one individual. Empirical studies generally report that CEO duality weakens disclosure quality and increases agency costs. For example, Zhang (2023) found that firms with CEO duality exhibit lower reporting transparency and weaker earnings quality.

However, empirical findings remain mixed. From a stewardship perspective, some studies suggest that unified leadership may improve strategic coordination and decision-making efficiency. Abiad and Ruaa (2025) argued that CEO duality may facilitate faster strategic decisions in dynamic business environments. In Chinese manufacturing firms, CEO duality is particularly important because ownership concentration and state influence may further strengthen managerial power. Existing literature suggests that CEO duality may influence investment efficiency by weakening board oversight and reducing investment discipline. Nevertheless, empirical evidence remains inconclusive regarding whether unified leadership ultimately improves or weakens long-term innovation performance.

Board size refers to the total number of directors serving on the board. Prior studies suggest that board size influences governance effectiveness by shaping monitoring capacity, expertise diversity, and strategic discussion quality. Larger boards may provide broader knowledge and stronger advisory capability, particularly in complex industries.Nouf Binhadab (2026) argued that larger boards improve access to external expertise and strengthen strategic oversight. Githaiga and Caroline Bonareri (2022) similarly found that larger boards improve reporting quality and governance transparency. However, other studies suggest that excessively large boards create coordination problems and reduce decision-making efficiency.Thirumagal (2023) noted that larger boards may suffer from communication difficulties and weaker accountability. These conflicting findings indicate that the relationship between board size and governance effectiveness may not be linear. Instead, governance outcomes may depend on the balance between expertise diversity and coordination efficiency.

Ownership concentration represents the proportion of shares controlled by major shareholders and is a common governance characteristic in Chinese manufacturing firms due to family ownership and state ownership structures. Prior studies suggest that concentrated ownership strengthens monitoring incentives because large shareholders have stronger motivation to supervise managerial behavior and reduce agency conflicts. Hashmi and Brahmana (2024) argued that ownership concentration improves governance effectiveness by enhancing shareholder monitoring and managerial accountability. However, the literature also highlights potential disadvantages associated with concentrated ownership. Guix and Mauri-Rfos (2025) emphasized that controlling shareholders may pursue private benefits at the expense of minority shareholders, thereby reducing transparency and governance quality. Consequently, empirical findings remain mixed. Some studies report that ownership concentration improves governance effectiveness, investment discipline, and strategic decision making, whereas others suggest that excessive concentration may weaken minority shareholder protection and distort

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resource allocation priorities. In the context of Chinese manufacturing firms, ownership concentration may influence innovation performance by shaping investment decisions, internal resource allocation, and long-term strategic priorities.

Corporate Governance and Innovation Performance

The relationship between corporate governance and innovation performance has received significant attention in recent years. Corporate governance influences how firms are directed and controlled, and it plays an important role in shaping strategic decisions related to innovation. From an agency theory perspective, governance mechanisms help reduce conflicts between managers and shareholders and encourage decisions that support long-term firm value (Jensen & Meckling, 1976). Since innovation activities often require substantial financial resources and involve considerable uncertainty, effective governance is important for ensuring that firms maintain long-term innovation commitments.

Prior studies generally suggest that strong governance structures contribute positively to innovation performance. Board independence is often associated with better monitoring and greater managerial accountability. Independent directors may encourage long-term investment decisions and reduce managerial short-termism, which can support innovation development (Garcia-Sanchez & Martinez-Ferrero, 2021). Ownership concentration may also strengthen shareholder monitoring and improve strategic decision making by aligning managerial actions with organizational objectives (Hashmi & Brahmana, 2024). In addition, governance mechanisms can improve transparency and information quality, thereby reducing uncertainty in innovation-related investment decisions (Wen & Deng, 2024).

However, empirical findings remain mixed. Some studies report positive relationships between governance mechanisms and innovation performance, while others find insignificant or negative effects. Abiad and Ruaa (2025) argued that excessive monitoring may discourage managerial risk-taking and reduce support for uncertain innovation projects. Similarly, Thirumagal (2023) suggested that some governance structures may reduce organizational flexibility and slow strategic decision making.

These inconsistent findings suggest that governance may not influence innovation performance directly. Instead, governance mechanisms may affect innovation through internal managerial processes that shape investment decisions and resource commitments. In Chinese manufacturing firms, innovation activities require continuous financial support and effective planning. Therefore, understanding the mechanisms through which governance affects innovation remains an important area for future research.

Internal Resource Allocation

Internal Resource Allocation from a Management Accounting Perspective

From a management accounting perspective, internal resource allocation represents the operational outcome of budgeting systems, planning mechanisms, and investment control processes. Chen and Gerschewski (2021) argued that budgeting systems influence not only cost control but also long-term strategic investment decisions. Similarly, Li and Da (2020) observed that management control systems guide managerial attention and shape capital allocation priorities across organizational activities.

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Innovation-oriented firms require sustained financial commitment and long-term planning discipline. Jiang (2024) emphasized that innovation activities involve substantial uncertainty and extended investment horizons, making effective budgeting discipline particularly important. Kaur and Singh (2025) found that firms sometimes increase investment expenditure due to policy incentives without achieving corresponding innovation outcomes. This finding suggests that stable and disciplined allocation processes are more important than temporary increases in investment spending.

The importance of allocation quality is particularly evident in manufacturing firms. Ye and Cao (2025) argued that manufacturing firms face high fixed costs and irreversible investment decisions. Inefficient resource allocation may therefore create overcapacity, financial pressure, and weakened innovation capability. Zhang and Zhu (2022) similarly found that Chinese manufacturing firms with weaker investment discipline exhibit lower productivity growth and reduced innovation sustainability.

Existing literature also highlights the role of governance mechanisms in shaping internal resource allocation quality. Agency theory suggests that managers may pursue overinvestment or inefficient projects when monitoring mechanisms are weak. Chen & Gerschewski (2021) argued that managerial opportunism may distort capital allocation decisions, particularly when firms possess substantial free cash flow. Governance mechanisms such as board independence and ownership concentration may reduce these distortions by strengthening monitoring quality and investment evaluation discipline.

Governance and Internal Resource Allocation

Prior studies increasingly suggest that governance mechanisms influence innovation indirectly through internal resource allocation processes. Chen and Gerschewski (2021) argued that governance structures affect budgeting discipline and long-term investment planning, which subsequently shape firms' strategic allocation decisions. Li and Da (2020) similarly observed that management control systems guide managerial attention and influence capital commitment priorities across organizational activities. Governance structures therefore affect budgeting discipline, monitoring effectiveness, and strategic investment evaluation, which subsequently shape firms' ability to maintain long-term innovation activities.

Independent directors may strengthen investment oversight and reduce inefficient allocation behavior by improving monitoring quality and increasing accountability (Garcia-Sanchez & Martinez-Ferrero, 2021). Omenihu and Chioma (2025) similarly found that board independence improves investment evaluation discipline and allocation quality. In contrast, Dakhli and Khelil (2025) argued that CEO duality may weaken investment discipline because concentrated leadership power reduces board independence and limits strategic challenge during investment evaluation processes. Board size and ownership concentration may also influence capital allocation decisions by shaping expertise diversity, monitoring incentives, and decision-making efficiency (Nouf Binhadab, 2026; Hashmi & Brahmana, 2024).

The literature therefore suggests that governance mechanisms should not be evaluated solely based on financial performance outcomes. Instead, governance effectiveness should also be examined through internal managerial processes such as budgeting discipline, capital allocation quality, and investment efficiency. Pratama and Pratama (2023) emphasized that

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innovation performance depends heavily on sustained and targeted investment commitment rather than isolated increases in expenditure. Internal resource allocation consequently represents a critical mechanism connecting ethical governance practices with sustainable innovation performance.

Table 1. Summary and Comparison of Previous Studies on Ethical Corporate Governance, Internal Resource Allocation, and Innovation Performance

Theme	Representative Studies	Main Findings	Limitations of Previous Studies	Research Gap
Innovation Performance	Schumpeter (1934); Forsman (2011); Khan & Ahmad (2022); Zhaoyuan & Yu (2025)	Innovation performance has evolved from focusing on technological outputs to incorporating innovation processes, organizational capabilities, and market outcomes.	Most studies emphasize innovation outcomes without considering governance-related managerial mechanisms that influence innovation success.	Limited research explains how governance practices affect innovation performance through internal organizational processes.
Corporate Governance	Jensen & Meckling (1976); Solomon (2021); Yassin & Al-Okaily (2025)	Corporate governance improves accountability, transparency, monitoring quality, and strategic decision-making.	Most studies examine governance effectiveness from monitoring or agency perspectives, with limited integration of management accounting processes.	The relationship between governance mechanisms and internal resource allocation remains underexplored.

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Theme	Representative Studies	Main Findings	Limitations of Previous Studies	Research Gap
Board Independence	Garcia-Sanchez & Martinez-Ferrero (2021); Naciti (2020); Yu (2023); Abiad & Ruaa (2025)	Independent directors generally enhance monitoring quality, disclosure transparency, and investment evaluation.	Evidence is inconsistent in emerging economies because board independence may be constrained by political influence or concentrated ownership.	More research is needed to determine whether board independence improves innovation through better resource allocation rather than through direct governance effects.
CEO Duality	Dakhli & Khelil (2025); Zhang (2023); Abiad & Ruaa (2025)	CEO duality may reduce board independence and increase agency problems, although unified leadership can improve strategic coordination.	Previous findings remain inconclusive regarding whether CEO duality promotes or hinders innovation performance.	Few studies examine the mediating role of internal resource allocation in explaining these inconsistent findings.
Board Size	Nouf Binhadab (2026); Githaiga & Caroline Bonareri (2022); Thirumagal (2023)	Larger boards may provide greater expertise and stronger oversight, whereas excessively large boards may reduce decision-making efficiency.	Existing studies report conflicting evidence and rarely consider contextual differences across industries and countries.	The influence of board size on innovation through strategic investment allocation requires further investigation.

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Theme	Representative Studies	Main Findings	Limitations of Previous Studies	Research Gap
Ownership Concentration	Hashmi & Brahmana (2024); Guix & Mauri-Ríos (2025)	Concentrated ownership strengthens monitoring incentives but may reduce minority shareholder protection and distort investment priorities.	Previous studies mainly focus on financial performance and governance effectiveness.	Limited evidence exists regarding how ownership concentration affects innovation through internal resource allocation.
Corporate Governance and Innovation Performance	Garcia-Sanchez & Martinez-Ferrero (2021); Wen & Deng (2024); Abiad & Ruaa (2025); Thirumagal (2023)	Good governance generally supports innovation by improving monitoring quality and strategic investment decisions.	Empirical findings remain inconsistent, with positive, negative, and insignificant relationships reported across different contexts.	Existing studies mainly examine direct relationships while overlooking internal managerial mechanisms linking governance and innovation.
Internal Resource Allocation	Chen & Gerschewski (2021); Li & Da (2020);; Jiang (2024); Ye & Cao (2025)	Effective budgeting, investment planning, and capital allocation improve innovation sustainability and investment efficiency.	Most studies investigate resource allocation independently from governance mechanisms.	The role of internal resource allocation as a mediating mechanism between ethical corporate governance and innovation performance remains insufficiently explored

Source:Compiled by the Author Based on Previous Studies.

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Methodology

This study adopts a narrative literature review approach to examine ethical corporate governance, internal resource allocation, and innovation performance in Chinese manufacturing firms. Relevant literature was retrieved from the Scopus, Web of Science, and Google Scholar databases using keywords including ethical corporate governance, internal resource allocation, innovation performance, and Chinese manufacturing firms. The review included peer-reviewed English-language journal articles published between 2015 and 2025, while books, conference papers, dissertations, and unrelated studies were excluded. The selected studies were screened based on their titles, abstracts, and full texts, and were subsequently synthesized thematically to identify key findings, research gaps, and relationships among the three constructs.

Conclusion

Ethical corporate governance has become increasingly important in supporting sustainable innovation and responsible managerial decision making, particularly under the current environment of technological disruption and industrial transformation. This study reviews the literature on corporate governance, internal resource allocation, and innovation performance in Chinese manufacturing firms. The review suggests that governance mechanisms, including board independence, CEO duality, board size, and ownership concentration, influence managerial monitoring, budgeting discipline, and strategic investment decisions. However, existing findings remain inconsistent across different institutional environments and ownership structures.

This study highlights that internal resource allocation is an important mechanism linking governance practices with innovation performance. Theoretically, this review integrates Agency Theory and management accounting perspectives to provide a better understanding of the governance–innovation relationship. Managerially, the findings suggest that firms should strengthen governance practices and improve resource allocation to support innovation. Policymakers should continue to promote governance reforms that encourage transparency and efficient resource allocation. This review is limited because it relies on published English-language studies and does not include empirical evidence. Future research should test the proposed relationships using empirical data and examine different industries and institutional contexts.

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