Corporate Governance and Profitability: Ownership Concentration as a Mediator

Mohammed Almashhadani & Hasan Ahmed Almashhadani
Department of Industrial Engineering, University of Houston
Department of Civil Engineering, University of Houston, United States
DOI - http://doi.org/10.37502/IJSMR.2023.6913

Abstract

This study digs into the complex world of corporate governance, a crucial but sometimes ignored aspect of the overall performance of European organizations. Prior studies have mostly focused on the link between ownership structures and company performance, but they have frequently neglected to examine the instrumental mechanisms that serve as middlemen in this relationship. Via a thorough investigation of the complex interactions between ownership types and company performance and a comprehensive examination of the various governance approaches and their resulting effects on firm performance indicators, this paper aims to close this research gap. Our study's specific attention on Ownership concentration as a mediator variable, which illuminates its critical role in forming the complex interactions between corporate governance structures and firm performance outcomes, is a novel and important component. The results of this study in case it will be considered from practical perspective, it will have significant ramifications for the corporate environment in Europe. The study provides useful insights for both business leaders and policymakers by illuminating the complex relationship between ownership forms and firm performance. It promotes a more comprehensive approach to corporate governance and emphasizes the significance of governance activities that go beyond simple ownership. Particularly, the recognition of Ownership concentration as a mediating factor makes clear a crucial lever that businesses can deliberately employ to improve their governance frameworks and eventually boost performance. From a theoretical standpoint, this work advances our knowledge of the complex dynamics inside corporate governance, which adds to the body of previous material. It enhances the theoretical framework guiding corporate governance research by looking into the factors that mediate the ownership-performance link. Researchers' toolkits are expanded by the addition of ownership concentration as a mediator variable, allowing for a more thorough investigation of how governance structures affect company performance. Empirically, this study offers hard facts and insights gleaned from a careful examination of actual corporate data. It provides an invaluable resource for upcoming empirical studies of corporate governance in the context of Europe. The empirical results support the theoretical hypotheses and highlight the usefulness of Ownership concentration as a significant factor in the relationship between corporate governance and performance. The originality of the research is one of its distinguishing qualities. Our emphasis on Ownership concentration as a mediator is a fresh and innovative way to comprehending the complexities of governance structures and their impact on business performance, whereas past research has mostly concentrated on traditional aspects of corporate governance. This work is a trailblazing contribution to the subject since this distinct viewpoint gives the continuing conversation on corporate governance a new
dimension. Finally, this study contributes to our theoretical knowledge of corporate governance and offers practical advice for European businesses looking to improve performance. This paper presents a convincing case for a more comprehensive and sophisticated approach to corporate governance procedures, eventually benefiting businesses, shareholders, and the larger economic environment by stressing the crucial function of ownership concentration as a mediator.

**Keywords:** Corporate governance, profitability, firm value, Ownership concentration, Europe

### 1. Introduction

The foundation that the framework and operations of contemporary organizations lie is corporate governance. The need of strong company governance cannot be stressed in a time of expanding globalization and increased competition. It includes a complex system of controls and procedures that drive the strategic course and day-to-day decisions of organizations, guaranteeing that they run effectively, morally, and openly.

**The importance of CGM**

Board composition: The makeup of the board of members is one of the pillars of corporate governance. Boards, which reflect the best interests of the stockholders, are at the forefront of strategic choice-making and monitoring. In order to ensure a balance of power, a diversity of viewpoints, and efficient decision-making inside the company, it is essential that the board's composition, especially the proportion of independent and chief executives, be considered.

Board Committees: As part of corporate governance practices, the development of specialist boards committees such the audit, remuneration, and nominating committees is also permitted. These committees offer specialized knowledge and oversight in crucial areas, boosting the accountability and openness of business processes.

Meetings of the board: The regularity and effectiveness of board meetings are important aspects of corporate governance. Planning a strategy, risk analysis, and strong discussions can all happen during regular board meetings. Boards' capacity to carry out their fiduciary responsibilities may be considerably impacted by how well these meetings are run.

CEO Duality/Separation: A key concern in corporate governance is the division of the CEO's and Chairman's responsibilities. It's common to think of separation as a way to reduce conflicts of interest and improve accountability. In contrast, CEO duality, in which one person holds both posts, can speed up making choices but runs the risk of giving that individual unfettered control.

**Influence on Firm Performance**

The performance of a company is significantly influenced by effective corporate governance processes. They serve as the guiding ideals that mold an organization's conduct and, eventually, define its marketability. Strong governance processes are more common in companies that:

Enhanced Accountability: Effective governance procedures guarantee that those making decisions are responsible for their deeds. By encouraging responsible behavior, this accountability lowers the possibility of dangerous or unethical behavior that could be detrimental to the firm.
Better Decision-Making: A board that is properly organized and backed by specialized committees is better able to make strategic decisions. As a result, finances and assets are allocated more wisely, ultimately boosting the company's performance.

Risk reduction: Corporate governance procedures assist in identifying potential risks and weaknesses through careful oversight and risk assessment. By taking a proactive strategy, businesses can reduce risks before they become serious, protecting their long-term profitability and stability.

Investor Confidence: Investors frequently pay more positive attention to companies with solid governance processes. Investors, both institutional and individual, are more likely to fund businesses if they have faith in the moral character of the leadership and the openness of business practices.

**Corporate Governance Systems and Firm Performance: A Relationship**

The intricate and multidimensional relationship between corporate governance practices and firm performance. Although there is broad agreement that good governance has a favorable impact on performance, the precise dynamics in play depend on a number of variables, including the distinctive corporate culture, the regulatory environment, and the ownership arrangements in a particular area.

This relationship is of special relevance to European businesses. The business environment in Europe is characterized by a variety of governance forms that reflect various historical, legal, and cultural influences. For business executives, investors, and legislators, it is essential to comprehend how these processes function in this environment and how they affect firm performance.

**The Problem statement (In the European Context)**

Corporate governance procedures have changed dramatically over time in the European setting. Optimizing these systems to attain optimal firm performance, meanwhile, still presents difficulties. An in-depth investigation is necessary due to the complicated environment created by the various governance models used by European countries, as well as differences in ownership systems and legal structures.

The statement of the problem that guides the research is the need to investigate and understand the complex interactions between particular corporate governance processes, like the makeup of boards, a committee building, board meetings, and CEO duality/separation, and their effects on company performance in European companies. It is crucial to pinpoint the elements that help or impede these systems' efficacy and to determine how they may affect the long-term expansion and profitability of European businesses. Addressing these concerns becomes crucial as Europe's corporate governance structure develops. This study seeks to close this knowledge gap by offering empirical understanding of the relationship between European corporate governance and performance, highlighting best practices and possible areas for development. The value of corporate governance processes assumes increased complexity and importance in the vibrant and diverse corporate environment of Europe. European nations display a rich tapestry of ownership structures, regulatory frameworks, and governance traditions, all of which contribute to the distinctive nature of corporate governance on the continent. The question that begs to be answered is how these particular governance
mechanisms—board arrangement, committee frameworks, board discussions, and the delicate equilibrium of CEO duality/separation—operate and interact in the various European corporate environments, as well as what exact effect they have on firm performance. Even though the corporate governance environment in Europe has made significant progress toward unifying and modernizing governance standards, ongoing problems nevertheless exist. A complex riddle that needs careful interpretation is presented by variations in national governance laws and a variety of corporate ownership patterns, from family-owned businesses to institutional investors. The regulatory directives of the European Union encourage convergence but provide plenty of room for regional differences. Therefore, negotiating this complex terrain is the main challenge. We must solve the riddle regarding how these governance mechanisms, in all of their varied manifestations, affect the course of European enterprises. Exist any specific characteristics of these processes that make them particularly useful or harmful in this situation? How do they maintain the essential values of corporate governance—transparency, accountability, and shareholder engagement—while adapting to the needs of a business environment that is continually changing?

One cannot express how important this investigation is. It is essential to look at how corporate governance affects the competitiveness, sustainability, and resilience of European enterprises as the continent maintains its position as a key hub for business and innovation. The knowledge gained from this study has the potential to help politicians create legal frameworks that encourage responsible business behavior and support economic growth throughout the European Union, as well as executives striving for perfection in governance. In this setting, this research sets out to shed light on the complex interactions that exist within the intricate web of European corporate governance between corporate governance instruments and business performance.

2. Literature review

Inconclusive results have come from empirical studies on the link among ownership structure and firm value in the United States of America, Eastern Europe, and the Asian continent (references withheld). It has been suggested that the structure of ownership might not consistently affect corporate value so long as management prioritise the needs of shareholders as an explanation for these contradictory findings (reference deleted). The channels by which corporate ownership dynamics infiltrate the larger corporate landscape, however, frequently go unnoticed. The relationship between ownership structure and business value must be examined along with crucial components of a firm’s operational setting, such as socioeconomic policies, governmental actions, laws, and regulations, in order to gain a more thorough understanding. In order to protect their own interests, various ownership types deploy different ownership structures, ownership concentration, and CEO-Chairman duality. This study tries to provide an integrated model that explains how these mechanisms are used by different ownership types. According to Jensen and Meckling (1976), there may theoretically be a tendency for firm value to drop as ownership and management of an organization become more disassociated from one another. This is because there may be a growing misalignment of interest between these two parties. The alignment of objectives may be tighter when ownership is concentrated in the hands of a single shareholder, which may increase the value of the company. There is a favorable association between ownership concentration and company performance in places like Thailand and Asia, according to recent studies by Alabdullah (2014), Alabdullah et al. (2023), and Alfakhri et al. (2020), as well as earlier work by Lins (2003). Because ownership
concentration has been found to reduce conflicts between owners and managers, this link is especially strong in nations with weak investor protection (Alabdullah, 2023). It is important to keep in mind, nevertheless, that the concentration of ownership and power may also result in managerial entrenchment and the predominance of the interests of the controlling shareholders. For instance, a U-shaped association between ownership concentration and firm value was found by Alabdulah et al. in 2023. Companies with ownership concentrations at both ends of the spectrum perform better than those with moderate shareholding levels by shareholders. This phenomenon is explained by the idea that "expropriation is minimal if the dominant stockholder owns an important ownership stake, thus absorbing the majority of the confiscation costs, or if no stakeholder has enough power to independently confiscate in the initial place" (Ahmed et al., 2017). By highlighting how the causes and effects of ownership concentration may differ among the main ownership types, this research goes beyond a cursory examination of the topic.

According to Alabdullah and Zubon in 2023, combining the positions of chief executive officer and chairman (also known as CEO-Chairman duality) may boost efficiency in managing management from the viewpoint of the dominant shareholder. By using this strategy, the requirement for significant contracting is reduced, and information imbalances are lessened. Individuals (referred to as INDs) with considerable holdings may strengthen their power over management and match company objectives with their personal interests by holding board posts, frequently concurrently as Chairman and CEO. According to Redding in 1996, active participation in daily operations enables IND to internalize transactional costs and improve firm performance by exploiting their position as the company's public face through tacit agreements and significant negotiation leverage. Alabdullah noted in 2023 that CG and its mechanisms have an important role in enhancing profitability. This strategy prevented the development of the nation's pool of qualified managers and discouraged investor education. In order to provide more effective oversight, it is acceptable to expect that controlling shareholders, notably IND, take a proactive involvement in managing their companies. According to research done in 2023 by Almashhadani & Almashhadani, employing comparable control mechanisms within state entities, foreign investors (FOREIGN), and trust accounts might not always enhance corporate performance. Monitoring becomes less effective as a result of increased transaction costs brought on by onerous bureaucratic contracting procedures. This is a result of the difficulty with "agents monitoring agents," which was noted by Alabdullah & Mohamed in 2023. Due to the absence of a single dominating shareholder who is able to internalize transaction and monitoring costs, FOREIGN, STATE, and TF may find it difficult to achieve the same efficiency in terms of reputation and bargaining as IND. The overseeing party and employees inside the organization may likewise have conflict of duty.

3. Conclusion

This study has made an effort to shed light on the complex dynamics within the European setting with regard to corporate governance and its significant implications for business performance. The study started off by highlighting the value of corporate governance systems, in particular the composition of boards, board committees, meetings of the board, and the duality/separation of the chief executive officer and Chairman, in directing the path of businesses and protecting the needs of stakeholders. We have examined the importance of firm performance, identifying it as the gold standard by which businesses are evaluated in the modern business environment. This study's direction was determined when it was determined
that the link between corporate governance practices and company performance was an important subject of investigation. We discovered a compelling issue statement when we looked at the European environment. A complicated picture that calls for in-depth investigation is created by the variety of governance models, ownership structures, and regulatory frameworks across European countries. We stressed the importance of comprehending how these corporate ownership dynamics interact with one another in the European corporate environment and how they affect company performance in light of the region's distinctive convergence of cultural, legal, and historical elements. We acknowledged the complex nature of this connection when we explored the delicate relationship between ownership forms and business value in this study. Examining the functions of controlling the stockholders, ownership concentration, and CEO-Chairman separation/duality, a complex interplay of forces that can either improve or worsen business performance was shown. In sum, this study aimed to advance both theoretical and practical knowledge of corporate governance in Europe. It emphasizes the necessity of a comprehensive strategy that takes into consideration the nuanced corporate environment in Europe, including the impact of socio-economic policies, governmental actions, laws, and regulations. This voyage has highlighted how crucial corporate governance practices are in determining the future of European corporations. It emphasizes how crucial it is for corporate governance processes to continuously adapt and innovate in order to satisfy changing global market needs. This study's findings provide insightful advice for legislators, investors, and business executives alike. We can promote ethical corporate behavior, increase shareholder value, and support regional economic progress by embracing the complexities of corporate governance within the European framework. The lessons learnt here will still be applicable as the corporate landscape changes, acting as a guide for negotiating the intricate relationship between corporate governance and business success in Europe and beyond.

References


