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The impact of corporate governance on investment confidence

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Literature Review

2.1 Concept of Corporate Governance

Corporate governance refers to the system of rules, practices, and processes by which a company is directed and controlled, ensuring accountability, fairness, and transparency in its relationships with shareholders and other stakeholders. The Cadbury Report (1992) defines corporate governance as the framework through which companies are governed and controlled, emphasizing board accountability and effective oversight. Similarly, the OECD (2023) describes corporate governance as the mechanisms that balance economic and social goals, align corporate objectives with shareholder interests, and ensure firm sustainability.

In emerging markets, corporate governance plays a particularly critical role due to weaker legal enforcement, concentrated ownership structures, and higher information asymmetries (Claessens & Yurtoglu, 2013). Effective governance reduces agency conflicts, enhances monitoring, and improves firm credibility, thereby fostering a more attractive investment environment. Governance quality is therefore increasingly viewed as a strategic asset rather than merely a regulatory requirement.

2.2 Investment Confidence: Concept and Measures

Investment confidence reflects investors' trust in a firm's ability to generate sustainable returns while managing risks transparently and ethically. It encompasses perceptions of financial reliability, governance integrity, risk management, and fairness in treatment of shareholders (Al-Ibbini & Shaban, 2021). High investment confidence translates into higher capital inflows, enhanced firm valuation, lower cost of equity, and improved liquidity.

Investment confidence has been measured using both market-based indicators, such as Tobin's Q, stock price volatility, liquidity, and abnormal returns, and perceptual indicators, such as investor trust, perceived risk, and willingness to invest (Gompers, Ishii, & Metrick, 2003). In emerging markets where market efficiency may be limited, perceptual and governance-signal based measures are often particularly relevant.

2.3 Theoretical Foundations

2.3.1 Agency Theory

Agency theory explains corporate governance as a mechanism to mitigate conflicts between managers (agents) and shareholders (principals). Jensen and Meckling (1976) argue that weak governance allows managers to act opportunistically, increasing agency costs and reducing firm value. Strong governance mechanisms—particularly board independence, monitoring, and transparency—reduce these conflicts, thereby improving investor confidence.

2.3.2 Investor Protection and Legal Perspective

The investor protection framework emphasizes the importance of legal rights, enforcement mechanisms, and shareholder protections in shaping governance outcomes. La Porta et al. (1998) demonstrate that stronger investor protection leads to deeper capital markets, higher valuations, and stronger investor confidence. In countries with weaker legal institutions, firm-level governance mechanisms become especially important as substitutes for weak external enforcement.

2.4 Corporate Governance Mechanisms

2.4.1 Board Effectiveness and Independence

Board effectiveness is a central pillar of corporate governance. Independent boards improve monitoring quality, reduce managerial entrenchment, and enhance strategic decision-making. Studies show that firms with a higher proportion of independent directors experience stronger governance outcomes and higher valuation premiums (Bebchuk, Cohen, & Ferrell, 2009). For investors, board independence signals credible oversight and reduces perceived risk.

2.4.2 Disclosure and Transparency

Disclosure and transparency reduce information asymmetry between firms and investors. High-quality, timely, and comprehensive disclosure improves market efficiency and allows investors to assess firm performance and risk accurately. The IFC (2025) emphasizes that transparency is a foundational mechanism through which governance affects investor

decision-making. Empirical evidence consistently shows that higher disclosure quality lowers the cost of capital and enhances investor trust.

2.4.3 Shareholder Rights and Minority Protection

Shareholder rights—including voting rights, protection against expropriation, and access to remedies—play a crucial role in investment confidence. Gompers et al. (2003) show that firms with stronger shareholder rights achieve superior stock performance and valuations. In markets characterized by ownership concentration, minority shareholder protection is particularly important in shaping investor perceptions.

2.4.4 Control Environment and Risk Oversight

The control environment encompasses internal controls, risk management systems, compliance functions, and internal audit activities. A strong control environment enhances financial integrity, supports regulatory compliance, and reduces operational and financial risks. IFAC (2023) highlights that robust risk oversight mechanisms are essential for long-term value creation and investor confidence, particularly in capital-intensive industries.

2.5 Empirical Evidence Linking Corporate Governance and Investment Confidence

A substantial body of empirical research confirms a positive relationship between corporate governance and investor outcomes. Gompers et al. (2003) find that firms with strong governance indices outperform weak-governance firms in terms of returns and valuation. Bebcuk et al. (2009) further identify specific governance provisions that significantly influence market outcomes.

Evidence from emerging markets supports these findings. Claessens and Yurtoglu (2013) report that improved firm-level governance compensates for weak institutional environments and positively affects investment behavior. Al-Ibbini and Shaban (2021) show that internal governance mechanisms significantly reduce stock price risk, thereby increasing investor confidence.

Despite these findings, results remain heterogeneous across industries and governance dimensions, underscoring the need for context-specific analysis, particularly in Saudi Arabia and GCC markets.

2.6 Research Gap and Conceptual Synthesis

Although prior studies establish a strong link between corporate governance and firm performance, fewer studies focus explicitly on investment confidence as a perceptual and behavioral outcome, especially within the Saudi and Gulf contexts. Existing research often treats governance as a single index without examining the mediating role of disclosure or the moderating effects of firm characteristics.

This study addresses these gaps by:

- Decomposing governance into specific mechanisms (board effectiveness, transparency, shareholder rights, control environment);
- Examining disclosure as a mediating variable;
- Testing contextual moderators such as ownership concentration and leverage;
- Focusing on investment confidence rather than purely financial performance metrics.

By doing so, the study contributes to both governance theory and practical policy formulation in emerging markets.

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