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The Role of Corporate Governance, Risk Behaviour, and Capital Structure on Financial Performance of Companies: Evidence from GCC Countries

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Abstract
This study examined the role of corporate governance, risk behaviour, and capital structure on financial performance of list companies within Gulf Council Countries. This is done through investigating the influence of three independent variables of (corporate governance, risk behaviour, and capital structure) over the dependent variable of financial performance. Data collected from 230 companies between 2016 and 2021 from Saudi Arabia, Kuwait, Qatar, United Arab Emirates, and Bahrain, and Oman. The findings suggested that CEO duality, size of the board, Debt to Equity (DTE) rationale and Debt to Asset (DTA) ration negatively impacted firm performance. However, the findings indicated that the audit committee positively influenced financial performance of companies.
Keywords: GCC, Corporate Governance , Risk Behaviour, And Capital Structure , financial performance
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1. Introduction

The globalization of business has brought corporate governance to the forefront of international discussions. According to Aman et al (2022), effective corporate governance is beneficial to both local communities and local enterprises. Corporate executives earn the public's confidence when they work to create a healthy environment for good corporate governance (Ge et al., 2021). The processes of legislation assist society avoid potential dangers and difficulties (Rahmat et al., 2022). The issue of corporate governance and company integrity was brought into question as a result of several accounting scandals that were caused by improper actions taken by top management in businesses (Abbasi et al., 2016). It was also regarded a key component for the expansion of businesses, the expansion of the economy, and the market for financial services (Paulson et al., 2021). In this manner, corporate governance is able to achieve a strategic position among those who determine policy (Mamirkulova et al., 2020).

It is generally agreed that good corporate governance and a well-structured capital structure are essential elements in expanding the wealth of shareholders. Good corporate governance in any company is an indicator that investors will be able to recover their money back with an optimal level of return on their investment, and a good capital structure is one that reduces the danger of bankruptcy and the likelihood of it happening. Corporate governance assists in attracting investments and enhances the financial health of organisations. Additionally, the principles of strong corporate governance safeguard investors and strengthen capital markets. The goal of many companies is to construct a company that takes into account the interests of its investors, which has led to the implementation of a two-tier corporate structure hierarchy. Insofar as capital structure is concerned, it all boils down to how a company manages and controls its growth and operations by utilising the financial resources of a variety of other companies. The quantity of money invested in a company is referred to as the "capital structure," and both owned capital and capital in the form of long-term debt are considered to be components of the capital structure of any company. Any corporation may benefit from improved corporate governance, which helps reduce the risk of catastrophic losses and bankruptcy and also makes businesses more accountable to their stakeholders. It is the method through which any business establishes policies and laws for its staff members, and it is used at every level of the organisation.

However, it should be noted that there is no single, universal model of corporate governance that is applied globally. As aptly put by Mubeen et al. (2021), the design of corporate governance structures may be rather different from one nation to the next, depending on the political, social, and economic climate of the respective country. With the increasing complexity and global nature of businesses, it has become increasingly important for companies to have effective systems in place for managing and mitigating risks, as well as for optimizing their capital structure. At the same time, the importance of good corporate governance in promoting accountability and transparency has become more prominent, as stakeholders demand greater oversight and responsibility from companies. This paper aims to explore role of corporate governance, risk behaviour, and capital structure on the financial performance of firms from the GCC. By doing so, this paper aims to provide insights that can inform the development of more effective strategies for managing and optimizing these factors

in order to enhance the financial performance of companies.

2. Literature Review

The relations between the examined variables in this paper are based on different theories. As such, the relationship between corporate governance and financial performance has been highlighted in different theories like stakeholder theory, resource dependence theory, stewardship theory, and signalling theory (Margaritis & Psillaki, 2007). Regarding the ways of approaching capital structure, different theories have been highlighted in the literature such as the pecking order theory which is about variances of information, and the trade-off theory about taxation, and the free cash flow theory which asserts on agency costs (Booth et al., 2001). In regarding to risk behaviour, the literature underlines different types of risk such as business risk, systematic risk, speculative risk, and financial risk) (Korosec & Horvat, 2005; Subramaniam et al., 2009).

Demsetz (1985) opined that the objectives, incentives, and monitoring abilities might be different for different types of management, such as people, families, organisations, and financial institutions. Due to the fact that they are completely and intensively involved in the growth of the company, the personnel have the potential to make a good and productive contribution to the expansion of the business they are monitoring. On the other hand, in order for businesses to protect their own best interests, financial institutions are able to effectively oversee managers thanks to the expertise and resources that are allocated to them by those businesses. In addition, Margaritis & Psillaki (2007) discovered that the aforementioned link holds true in New Zealand based small and medium-sized businesses, which provided additional evidence for the agency cost argument. The impact that leverage has on the operational performance of businesses was the subject of a great number of studies that looked at developing markets. Using information from the Pakistani corporate sector from 2009 to 2013, Muhammad et al. (2014) provided a description of the negative association between a company's capital structure and its overall performance.

Lipton & Lorsch (1992) determined that the effectiveness of a company is directly related to the size of its board of directors. Ashraf et al. (2020) confirmed that having a smaller board will boost the company's success. Indeed, both Badar & Irfan (2018) and Zhu et al., (2021) averred that despite the fact that larger boards have the advantage of maximal supervision, the end result might be ineffective communication and decision making of the board thus resulting in a detrimental impact on the functioning of the organisation. Anderson et al., (2003) made the observation that creditors are more impressed by companies with bigger boards on the premise that such firms are better placed to protect their interests by utilising a more efficient instrument to monitor the financial accounting procedures. According to Brown & Caylor (2006), big businesses with boards consisting of 6–15 members have a tendency to generate a greater ROE and thus larger profit margins.

Research undertaken by Core et al. (1999) revealed that the remuneration provided to the CEO is lower in the absence of CEO duality where the individual is a woman. Frankel et al. (2002) discovered that there is an inverse correlation between the independence of auditors and the management of earnings. Agarwal & Knoeber (1996) found that these mechanisms were interdependent on one another during their research. It was determined through deduction that a favourable performance need not be produced by a single mechanism in order to be considered required. It is possible that the combination of processes will produce better results.

According to the research of Triki & Dionne (2004), corporate financial features and internal governance structures may each have a part to play in the process of risk management. According to their model, higher financial coverage does not always result in a bigger capacity for taking on debt. The business's financial coverage is becoming an increasingly important role in response to the rising expenses of the company's financial difficulties. According to the findings, the composition of the board does not have an effect on the risk management process. The manner in which a company takes risks may have a considerable impact on the results that it achieves.

Traditionally, audit committees are responsible for ensuring that risks are properly managed (Korosec & Horvat, 2005). These committees report directly to the board of directors in a variety of jurisdictions throughout the world. This kind of committee is beneficial because it assists companies in acquiring the information they want, which enables them to improve their internal control systems and come up with solutions that provide them the ability to deal with risk.

According to Gray (2006), factors like social and environmental initiatives, as well as the significance of transparency, are variables that contribute to the shareholder value of corporations. The fact that the information contained in these reports is made available to the general public helps to establish a company's credibility. When businesses provide information that is not only accurate but also essential to their operations, it makes a substantial contribution to the development of a climate of trust among the various stakeholders.

Kose et al. (2008) conducted an investigation on the correlation between motivation for managers to take risks and investor protection involving samples from 39 countries. In addition to this, they concentrated on the processes of governance that impact investment risk management decisions and the consequences of these choices for growth. According to the findings, there is a positive relationship between the level of investor

protection and risk-taking as well as the pace at which businesses expand their operations. These writers believe that a negligent approach to investor protection can significantly increase risk. Leaders in nations where there is a low level of protection for investors have the ability to participate in hazardous but profitable initiatives if doing so would benefit their personal interests.

In their study on the organisational structure of risk management committees in corporations, Subramaniam et al. (2009) used data obtained from the annual reports of 300 publicly listed companies in Australia in 2005 as their primary source of information. In particular, the researchers focused their attention on elements connected to the deployment of risk management committees and explored those. These variables included the diversity of management roles, the availability of independent directors, the characteristics of the firms, and the board size. According to the findings, the presence of risk management committees is positively correlated with the size of an organization's board of directors as well as the proportion of independent directors on that board. The data also showed that corporations have a higher propensity to maintain risk and audit committees apart from one another than previously thought. If businesses operate in this manner, there is a greater likelihood that their boards of directors will be larger, there will be fewer financial risks, and there will be lower complexity levels in their organisations.

Gordon et al. (2009) carried out study to investigate the influence that risk management has on the performance of companies and observed that there is a correlation between the two factors. The findings of this study brought to light the relevance of five different features of businesses, including the complexity and scale of the organisation, the unpredictability of the external environment, the presence of a supervisory board of directors, and the intensity of the competition.

Mongiardino & Plath (2010) demonstrated that despite the rise at the amount of pressure exerted by regulators on major banks, risk management in these institutions is still considered inadequate. Even if these institutions do create risk management committees, the authors claim that these committees seldom hold meetings even when they do. As a result, the individuals serving on these committees do not meet the criteria for either independence or financial management expertise. Moreover, the majority of its members ought to be independent. In addition, it is required that the majority of its members be independent. Making public the company's reports that fall within its environmental and social strategy is another way for a company to manage risks as well as other social needs.

Aebi et al. (2021) collected data from 573 banks to investigate the correlation between the risk management practices of corporate governance systems and the performance of banks. The results showed that financial institutions with a director of risk management directly reporting to the board of directors demonstrated better return on equity performance during times of economic uncertainty. On the other hand, it was discovered that the influence of the governance of the company had either no bearing at all on the performance of the banks or even a negative correlation with it. Banks need to considerably increase the quality of their risk management undertakings in order to be risk adverse to financial crisis. One way that this might be accomplished is by incorporating specialist risk committees.

Oladeji et al. (2015) analysed the correlation between the financial performance of firms and capital structure by analysing data spanning 10 years for Nigerian enterprises. The research revealed that there is a positive and substantial association between both variables. San & Heng (2011) carried out yet another study on company performance and the capital structure in Malaysia’s construction industry in 2005–2008 from a sample 49 companies. It was discovered that there is a considerable connection between a company's success and its financial structure. Nawaz & Ahmad (2017) revealed a correlation between debt and return on assets. The researchers opined that the firm’s short-term and long-term debt ratios should be reduced for improved financial performance, but that the number of shareholders and the size of the board had no bearing on the company's return on assets. Tailab (2014) investigated the effect of capital structure on financial performance by using proxies for profitability that were comparable to those employed in the previous study. The researchers found that there was a substantial correlation between the total debt and ROE and ROA.

Narwal & Jindal (2015) examined correlation between corporate governance and the financial performance of Indian textile firms and observed that the presence of non-executive directors, board size, and the frequency of board meetings had no bearing on the profitability of the firm. Moreover, the researchers revealed that the directors' compensations have a favourable effect on the profitability of the company. Similarly, the link between NPR and ROA is significantly impacted by the long-term debt. Jamal & Mahmood (2018) came to the conclusion that audit committee and board size had no significant connection with financial performance when doing their research in Pakistan between the years 2007 and 2016. Vo & Nguyen (2014) performed research utilising data from companies that were listed on the stock exchange and concluded that a negative correlation exists between the independence of the board of directors, CEO duality, and business performance.

Habib (2016) discovered that the board size had a negative correlation with the performance of the company, whereas the presence of women on the board, having a co-CEO, and increasing board compensation had a significant and positive correlation with firm performance. The purpose of Ahmed et al (2019) study is to

investigate the influence that a company's capital structure and corporate governance have on the financial performance of a firm. According to the data, the size of the board has a positive link with a company's profitability. In addition, a positive correlation exists between the current ratio and financial outlook. However, a negative correlation exists between the debt-to-equity ratio and financial performance.

Qiu et al. (2016) investigated the relationship between financial performance of the firm and the environmental and social initiatives of those organizations using a sample of 629 FTSE 350 Index trading firms from 2005 to 2009. This research was conducted using the years 2005 to 2009. According to the findings, there is no meaningful connection between the knowledge about the environment and the profitability of the business. In addition, while the majority of the research that has been done has been on the significance of making environmental information publicly available, Qiu et al. (2016) discovered that investors care more about social information. They found that companies that disclosed accurate information about their social practises had higher stock prices, which led to an increase in the cash flow rates of these companies. Given the historical significance of social problems that are brought up in the framework of the economy, this remark may be seen as a case that is tied to the institutional setting of Britain. These findings are also in line with the findings of a research by Marsat & Williams (2014), which found that investors all around the world are becoming increasingly worried about the performance of individual companies.

PeiZhi & Ramazan (2020) demonstrated that the system of corporate governance is essential to the success of organizations. According to the findings, successful businesses are characterised by the presence of an independent auditor, a board of management, female directors, an audit committee, and institutional investors.

2.1. Theoretical Framework

On the basis of the foregoing literature review, the following research-specific theoretical framework was established. This model illustrates the correlation between corporate governance, risk behaviour, and the capital structure of an organisation and how it affects the organization's financial performance.

Research Hypothesis

On the review, the following hypotheses have been developed:

1. H_1: Corporate governance significantly affects the firm's financial performance.
2. H_{1a}: Board size correlates with the firm's financial performance.
3. H_{1b}: Chairman duality correlates with the firm's financial performance.
4. H_2: Risk behaviour significantly affects the firm's financial performance.
5. H_{2a}: Audit committee size correlates with the firm's financial performance.
6. H_3: Capital structure significantly affects the firm's financial performance.
7. H_{3a}: Debt to assets affects the firm's financial performance.
8. H_{3b}: Debt to equity affects the firm's financial performance.

Based on the above research hypothesis, Table 1 below offers the variables under investigation:

Table 1: Variable Under Investigation

	Variable	Initials
1	Firm Performance	(Return on Assets) ROA
2	Corporate Governance	(Board Size) BS
3	Corporate Governance	(Chairman Duality) CD
4	Risk Behavior	A(Audit Committee Size) CS
5	Capital Structure	(Debt to Asset) DTA
6	Capital Structure	(Debt to Equity) DTE

3. Methodology

The ensuing treatise adopted a deductive and quantitative approach using the variables outlined in Table 1. The sampling population was from 230 firms from across the GCC member states. Convenience sampling approach was used to collect the secondary data based on company annual statement data from 2016 to 2021. Whereas a five-year data appeared to be minute, Kouloukoui (2019) asserted that such data would be sufficient in such an undertaking.

For the purposes of evaluating the correlation between the dependent and independent variables, the regression model below was used.

$$ROA_{i,t} = \beta_1 + \beta_2\left(\frac{TD_{i,t}}{TA_{i,t}}\right) + \beta_3\left(\frac{TD_{i,t}}{TE_{i,t}}\right) + \beta_4 BS_{i,t} + \beta_5 CD_{i,t} + \beta_6 AC_{i,t} + \varepsilon \quad (1)$$

where *i,t* implies the firm and year, TA as Total Assets, TE as Total Equity, BS as Board Size, CD as CEO Duality, AC as Audit Committee Size, and **ε** as the error term.

4. Data Analysis, and Discussion

The above data from the firm was collected and summarised as show in Table 2 below.

Table 2: Summary of Descriptive Statistics (2016-2021)

	ROA	D/A	D/E	BS	CD	AC
Mean	−0.0065	0.9720	2.5129	7.8522	0.3391	3.0870
Standard Error	0.0173	0.1405	0.3836	0.0910	0.0443	0.0264
Median	0.0184	0.6918	1.9649	8.0000	0.0000	3.0000
Standard Deviation	0.1854	1.5071	4.1141	0.9755	0.4755	0.2830
Range	1.5739	12.0389	34.5279	3.0000	1.0000	1.0000
Minimum	−1.2071	0.1241	−1.9513	7.0000	0.0000	3.0000
Maximum	0.3669	12.1630	32.5766	10.0000	1.0000	4.0000
Sum	−0.7471	111.7776	288.9851	903.0000	39.0000	355.0000
Count	115	115	115	115	115	115

According to the data presented in Table 2, the average return on assets (ROA) for the selected companies is approximately 0.65%. This means that for every $100 worth of assets, the company incurs a loss of $0.65.

Additionally, the findings indicate that the average board size for these companies is seven members. In 34% of the companies studied, the is absence of CEO duality. The membership in the Audit Committee tends to range from two to three, on average.

The mean DTA and DTE ratios are 0.9720 and 2.5129 respectively. These ratios suggest that the companies have a high level of debt and therefore face a significant amount of risk. In particular, the fact that debt was used to fund 97.20% of the total assets of the company appears to be the main contributor to the negative ROA.

Correlation is used to demonstrate the existence of a connection between two or more variables by observing how those variables change in tandem over time. A positive correlation shows that the two variables move in the same direction, either increasing or decreasing. The degree to which one variable grows while another one falls is shown by a negative correlation between the two variables. In this regard, a correlation analysis was undertaken and presented in Table 3 below.

Table 3: Data Correlation

	ROA	D/A	D/E	BS	CD	AC
ROA	1.000					
D/A	−0.704	1.000				
D/E	−0.040	−0.147	1.000			
BS	−0.086	0.108	−0.262	1.000		
CD	−0.274	0.345	0.062	−0.175	1.000	
AC	0.088	−0.080	0.034	0.015	−0.156	1.000

At the 5% level, the results shown in Table 3 indicate that a negative correlation exists between ROA and CEO duality at 0.274, board size at 0.086, D/A ratio at 0.704, and D/E ratio at 0.040. Additionally, the size of the audit committee is positively correlated with both the return on assets and the strength of the connection.

According to the findings, an organization's assets, as well as its return on assets, would suffer if it maintains a high debt level and a high level of financing, while the opposite is also true. The board size and whether or not the CEO is dual-hatted are other factors that influence their return on assets. This is due to the fact that both factors contribute to a decline in the ROA and income generated by the firm.

With the above, a further regression analysis was undertaken with the results presented in Table 4 below.

Table 4: Results from Regression

	Coefficients	Standard error	t stat	*p*-value
Intercept	0.1146	0.1750	0.6546	0.5141
D/E	−0.0071	0.0031	−2.2753	0.0248
D/A	−0.0874	0.0089	−9.7901	0.0000
BS	−0.0106	0.0134	−0.7897	0.4314
AC	0.0220	0.0440	0.4994	0.6185
CD	−0.0094	0.0286	−0.3270	0.7443
R	0.722		R^2	0521
Adjusted R^2	0.499		Standard Error	0.131

The adjusted R^2 of 0.499 suggests that the independent variables in the regression model are able to explain approximately half of the variance in the dependent variable. This indicates that the chosen independent variables have a strong effect on the dependent variable, and that they are able to capture a significant portion of the underlying relationship between the two. However, it should be noted that the adjusted R square value does not take into account the overall goodness of fit of the model, or the statistical significance of the individual independent variables. Therefore, it is important to consider these factors in addition to the adjusted R square value when evaluating the overall strength and relevance of the model.

The deduced results tabulated in Table 4 indicate that the ROA (dependent variable), is influenced by the evaluated independent variables: DTA, DTE, BS, AC, and CD. The coefficients for these variables are −0.0874, −0.0071, −0.0106, 0.0220, and −0.0094 respectively. The t-values for DTA and DTE are −9.79 and −2.275 respectively, which are both greater than 2.00 and suggest that these variables are statistically significant and have a negative impact on firm performance. In addition, the p-values for DTA and DTE are 0.000 and 0.025 respectively, which are both below the level of significance (0.05). This indicates that capital structure is a significant predictor of firm performance, and that a higher level of debt is associated with lower levels of financial performance.

Moreover, the t-values for audit committee, CEO duality, and board size are 0.499, −0.327, and −0.79 respectively. Cognisant that the values were less than 2.00, it was not statistically significant. In addition, the *p*-values for these variables are all greater than 0.05, which suggests that corporate governance does not have a substantial effect on the financial outlook of an organization.

5. Conclusion

The paper examined the relationship between risk behaviour, capital structure, business performance, and corporate governance in companies operating in the GCC region over the period of 2016-2021. Business performance was used as the dependent variable, while corporate governance, risk behaviour, and capital structure were treated as independent variables. The results indicated that chairman duality, DTE ratio, board size, and DTA ratio had a negative and statistically significant impact on firm performance. This suggests that a decrease in these variables is associated with an improvement in business performance. In contrast, the audit committee was found to have a positive correlation with company performance, indicating that an increase in the membership of audit committee members is correlated with an increase in business performance. Overall, these findings highlight the importance of capital structure, risk behaviour, and corporate governance in the financial outlook of companies. Companies that are able to effectively manage their debt levels and implement strong systems for corporate governance are likely to be more financially successful. On the other hand, those that have high levels of debt or weak corporate governance systems may struggle to achieve optimal performance. These results have implications for policymakers and practitioners in the GCC region, as they can inform the development of strategies for improving capital structure, risk management, and corporate governance in order to enhance business performance.

Through the analysis of a range of data sources, this study has identified a number of key trends and patterns that are relevant to understanding the relationship between these factors and financial performance in these countries. Some of the key findings of this study include the importance of strong corporate governance in promoting accountability and transparency, the role of risk management in mitigating financial risks, and the impact of capital structure on a company's ability to optimize its financial performance. Overall, this treatise has contributed to the existing body of knowledge on corporate governance, risk behaviour, and capital structure, and has provided insights that are relevant to policymakers and practitioners in the GCC region. By better understanding the relationship between these factors and financial performance, stakeholders can develop more

effective strategies for managing and optimizing these factors in order to enhance the financial performance of companies in the GCC region.

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