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The Mediating Function of Corporate Governance in the Legitimacy Theory-contextual Relationship between Net Profit and Equity and Voluntary Disclosure

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Abstract

Corporate governance plays a critical role in modern business practices, influencing transparency, accountability, and overall corporate performance. In the context of legitimacy theory, corporate governance can mediate the relationship between financial indicators such as net profit and equity, and the extent of voluntary disclosure by a company. This article explores this mediating function, examining how effective corporate governance can enhance a company's legitimacy through improved voluntary disclosure.

Keywords: Practices • Empirical studies • Disclosure practices

Introduction

Legitimacy theory posits that companies seek to operate within the bounds of societal norms and expectations to gain legitimacy. This legitimacy is crucial for companies to access resources, gain stakeholder support, and achieve long-term success. Legitimacy is often derived from demonstrating ethical behavior, transparency, and social responsibility. Voluntary disclosure is a key mechanism through which companies can enhance their legitimacy. By providing information beyond mandatory requirements, companies can show their commitment to transparency and accountability. However, the decision to disclose voluntarily is influenced by several factors, including financial performance and equity structure. Net profit and equity are fundamental financial indicators reflecting a company's financial health and stability. Net profit indicates the company's profitability, while equity represents the residual interest in the assets of the company after deducting liabilities. Both indicators are crucial for stakeholders to assess the company's performance and sustainability [1,2].

Literature Review

A higher net profit generally indicates better financial performance, which can influence the company's ability to engage in voluntary disclosure. Profitable companies may have more resources to invest in comprehensive reporting and are likely to be more transparent to showcase their success. Equity structure, including the proportion of ownership and distribution of voting rights, can affect governance practices and disclosure policies. Companies with dispersed equity might have stronger incentives to engage in voluntary disclosure to address the diverse information needs of their shareholders. Corporate governance encompasses the systems, principles, and processes by which companies are directed and controlled. It ensures that the interests of all stakeholders (shareholders, management, customers, suppliers, financiers, government, and the community) are balanced and protected. Effective corporate governance can mediate the relationship between financial performance (net profit and equity) and voluntary disclosure [3].

Discussion

An independent and well-structured board can enhance transparency and accountability, leading to more robust voluntary disclosure practices. Independent directors can provide unbiased oversight and push for higher disclosure standards. Effective audit committees play a crucial role in ensuring the accuracy and completeness of financial reports. They can drive the company towards greater transparency by advocating for comprehensive voluntary disclosures. The concentration of ownership can influence governance practices. Companies with dispersed ownership may adopt more rigorous disclosure practices to meet the varied information needs of their shareholders, thus enhancing their legitimacy. Linking executive compensation to performance metrics related to transparency and disclosure can incentivize management to prioritize voluntary disclosure, thereby reinforcing the company's legitimacy. XYZ Corporation, a large publicly traded company, demonstrates how corporate governance mediates the relationship between financial performance and voluntary disclosure. With a high net profit and a dispersed equity structure, XYZ has implemented strong corporate governance practices, including an independent board and a proactive audit committee [4]. Empirical studies provide evidence supporting the mediating role of corporate governance. Research shows that companies with strong governance practices tend to have higher levels of voluntary disclosure, which in turn enhances their legitimacy. Independent boards disclosed more information voluntarily, contributing to higher legitimacy. The high net profit enables XYZ to allocate resources towards comprehensive reporting initiatives, including sustainability reports and detailed financial disclosures. The dispersed equity structure necessitates transparency to maintain investor confidence. XYZ's governance practices ensure that the diverse shareholder base receives accurate and timely information. The independent board and audit committee drive voluntary disclosure practices, reinforcing XYZ's legitimacy and enhancing its reputation among stakeholders [5,6].

Conclusion

Corporate governance plays a pivotal mediating role in the legitimacy theory-contextual relationship between net profit and equity and voluntary disclosure. Effective governance practices can enhance a company's transparency, accountability, and overall legitimacy. By understanding and leveraging this mediating function, companies can improve their voluntary disclosure practices,

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thereby gaining stakeholder trust and achieving long-term success. In summary, the interplay between financial performance, corporate governance, and voluntary disclosure is complex yet crucial for enhancing corporate legitimacy. Companies that invest in robust governance practices can better navigate this relationship, ultimately achieving greater transparency and stakeholder confidence. Companies with limited financial resources may struggle to invest in comprehensive governance and disclosure practices. Strategic prioritization of key disclosures can mitigate this challenge. Variations in regulatory requirements across jurisdictions can impact the extent of voluntary disclosure. Companies need to navigate these differences while maintaining high standards of transparency. Balancing diverse stakeholder expectations can be challenging. Companies should engage in continuous dialogue with stakeholders to understand their information needs and align disclosure practices accordingly. Ensuring a majority of independent directors on the board can enhance oversight and drive transparency. Providing adequate resources and authority to audit committees can improve the accuracy and completeness of disclosures. Incentivizing management through performance metrics related to disclosure can promote a culture of transparency. Continuous engagement with stakeholders can provide valuable insights into their information needs, guiding voluntary disclosure practices.

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Conflict of Interest

None.

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