Article

Interaction between Governance Structure and Enterprise Innovation

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Abstract: The corporate governance structure is closely related to enterprise innovation. A scientific governance structure can standardize enterprise management, promote equity concentration and balance, improve decision-making efficiency, and enhance competitiveness, providing a favorable environment for innovation. Meanwhile, the governance structure also influences corporate culture, resource allocation, and other factors, thereby affecting innovation behavior. Therefore, optimizing the governance structure is crucial for driving enterprise innovation. The article delves into the intricate relationship between corporate governance structure and enterprise innovation, underscoring its significance in emerging economies. It posits that innovation is not merely a byproduct of a company's evolution but a strategic imperative for sustainable growth, examines how governance mechanisms, including board composition and equity distribution, can either stimulate or stifle innovation. Emphasizing the role of a balanced governance framework in fostering a culture conducive to innovation, it suggests that while certain structures may optimize decision-making and resource allocation, others might introduce bureaucratic hurdles. Drawing on empirical evidence, the piece offers insights into how companies can recalibrate their governance to enhance innovation, thereby improving competitiveness and market standing.

Keywords: Corporate management, Governance structure, Innovation, Development

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1. Introduction

In recent years, the overarching theme of economic structural adjustment has been the Revolutionary evolution and upgrading of enterprises, constituting a pivotal practice across diverse domains of enterprise management. This evolution is particularly significant for emerging economies, as it holds the potential to catalyze their sustained development. Within the context of enterprise transformation and development, the matter of innovation is intertwined with the enterprise's capacity for long-term stability and resilience. As enterprises continue to operate and expand, critical factors such as their functional architecture and market clientele undergo incremental yet profound changes. These shifts are further influenced by the confluence of environmental dynamics and policy directives, often resulting in a lag in the alignment of systems and products with current market demands. To safeguard their industry leadership, attract top talent, and sustain economic growth, enterprises are increasingly recognizing the urgency of innovative behavior (Lipych et al., 2018), particularly during pivotal operational junctures. Continuous refinement of outdated products and proactive exploration of emerging trends are paramount for enterprises to break through inherent barriers and seize new growth opportunities. Concurrently, the governance structure within enterprises serves as a comprehensive framework for managing and controlling the organization. It establishes a system of checks and balances, ensuring that stakeholders are held accountable and operate within prescribed parameters. As the bedrock of internal management and decision-making, the

governance structure has profound implications for the healthy development of the enterprise. Different types of governance structures have a significant impact on factors such as decision-making and operational efficiency, internal risk control, and profit distribution, and the trust of market investors, company agency costs, brand image, and business expansion will also change with changes in governance structures. This also directly affects the internal stability of the company and the number of external customers, achieving supervision, motivation, and coordination of business management and performance, and ensuring the effectiveness of resource allocation. So, the design of governance structure is the foundation for the normal operation of enterprises. Among them, different governance structures can also have an impact on the innovative models they generate, and there is an inseparable relationship between the two. From a macro perspective, different corporate governance structures have a mutual influence on corporate strategic orientation, market environment changes, and organizational culture characteristics, and the results of their interaction determine the atmosphere, efficiency, and support foundation of corporate innovation. A scientific corporate governance structure can standardize the operation and management of enterprises (Ehikioya, 2009), promote the increase of equity concentration and the strengthening of equity balance, clarify the relationship between rights and responsibilities, improve decision-making efficiency, enhance enterprise competitiveness, and reduce operational risks, thus forming a virtuous cycle. Using structural norms to promote the rationalization of corporate governance undoubtedly provides a favorable environment for enterprise innovation, promotes the mechanism and motivation of innovation, and ultimately achieves the goal of optimizing innovation performance. Based on the impact relationship between the two, combined with the advantages of large scale, complete industrial chain, and digital transformation presented by enterprises in the new normal of economic development, as well as the disadvantages of weak technological development ability, outdated management mechanisms and ideas, it is necessary to continue to pay attention to the governance structure of the enterprise itself and make improvements and optimizations at the appropriate time to promote the emergence of substantive innovation behavior, achieve market expansion, and increase profitability.

2. Enterprise governance structure and innovation

In the intricate details of corporate governance, each enterprise possesses an internally crafted management framework and mechanism that is comprised of several pivotal components. These components are essential to ensure that the company's operations and decision-making processes adhere to legal, regulatory, and commercial norms, while also facilitating a reasonable distribution of interests among all stakeholders. This intricate structure encompasses various facets such as management and decision-making processes, the board of directors, the supervisory board, operational departments, administrative functions, rights protection units, participation mechanisms, risk mitigation strategies, information disclosure practices, and the equity structure. These components of the governance structure play a pivotal role in shaping the developmental trajectories and operational landscapes of enterprises (Singh and Ajai, 2013), including their capacity for organizational innovation. The most typical corporate governance structure is the mutual relationship framework formed by the owners, board of directors, and executives of the enterprise, as shown in Figure 1.

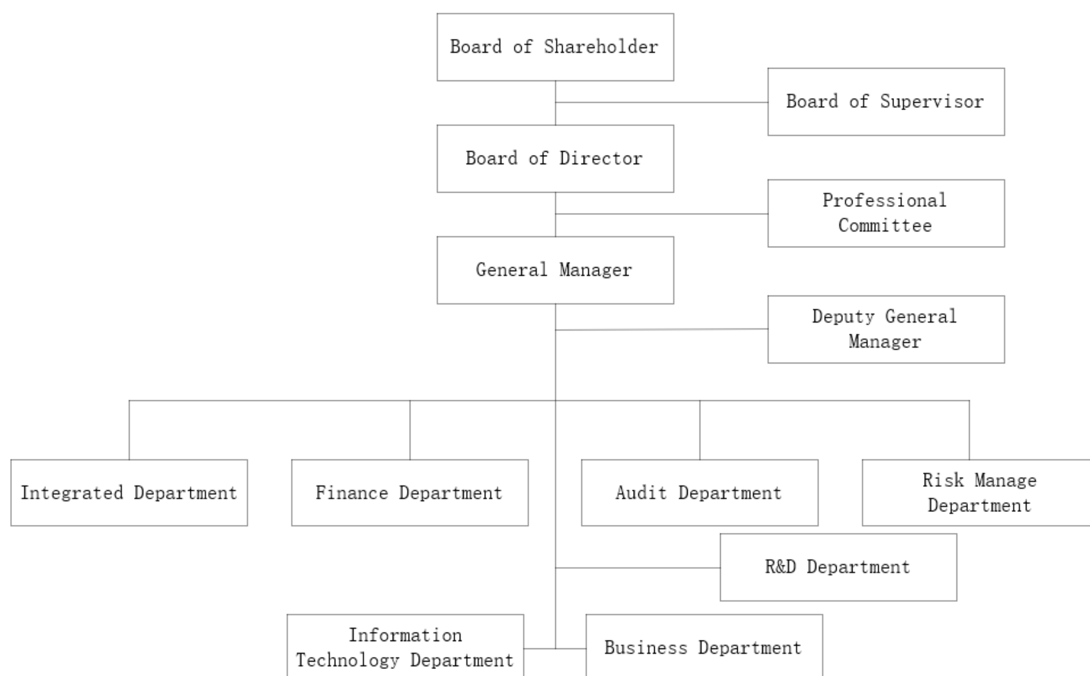

Figure 1. Corporate governance structure.

The corporate governance structure holds paramount significance in the context of enterprise business development, necessitating a multifaceted approach that converges on three crucial aspects. Firstly, it is essential to harmonize the interests of shareholders and the enterprise. In a scenario of separated ownership and control, the potential for an imbalanced equity structure, failed gambling agreements leading to equity transfers, or the influx of new investors resulting in equity dilution, poses a threat to shareholder control. Such scenarios can result in the enterprise being steered by managers, who may leverage their significant influence to pursue self-serving agendas that undermine shareholder interests, ultimately leading to shareholder withdrawals and impediments to long-term enterprise development. Therefore, the corporate governance structure must ensure shareholder control and interests through institutional mechanisms. Secondly, the governance structure must foster harmony among diverse stakeholders. A scientifically designed governance structure enables external regulation of user numbers through departments such as business and public relations. Internally, it effectively regulates managerial conduct, motivates management and other employees, and manages the intricate relationships between various interest groups within the enterprise. By formulating targeted control and governance strategies for senior to middle-level managers, and subsequently extending them to grassroots staff, the governance structure mitigates the negative consequences of decision-making errors at higher levels. Lastly, the governance structure enhances the enterprise's resilience to risks (Guo et al., 2014). In the process of continuous development, the scale of enterprise operations continues to expand, and the relationships between new employees and old systems, internal interests, and between enterprises, as well as between enterprises and local government departments, have become increasingly complex. The probability of various risks such as management issues, sustainable development issues, and interest distribution issues continues to increase. With the assist of a reasonable corporate governance structure and standardized institutional construction, conflicts between different interest relationships can be effectively coordinated, and potential medium - and long-term risks can be optimized and improved, which helps to improve the resistance and health of enterprises in the face of risks.

Substantive innovation, which aligns closely with strategic innovation, serves as a pivotal approach for corporate innovation. However, strategic innovation tends to prioritize selective industrial policy advancements through the refinement of existing business models, including marketing strategies and supply chain management. This approach represents an innovative strategy that responds to regulatory and governmental imperatives, emphasizing both the quantity and speed of innovation. In contrast, the substantive innovation discussed in this article represents a "high-quality" innovation endeavor focused on propelling technological progress and fostering competitive advantages for enterprises (Fernandes, 2013). This innovation manifests primarily at the granular level of the organization, encompassing areas such as product innovation, process optimization, and service enhancements. These initiatives not only elevate product quality and performance but also contribute to cost reduction, enhance user experiences, and confer substantial competitive advantages to the enterprise. It is worth noting that substantive innovation necessitates an initial investment, yet its successful implementation often yields significant returns and immense value for the organization. A prime example of substantive innovation in practice is Apple's technological product advancements. The company's mobile phones, tablets, and other offerings, with their distinctive industrial design, intuitive user interface, and robust ecosystem, have revolutionized the traditional smart device market. These substantive innovations have not only influenced consumer usage patterns but have also generated immense benefits for Apple, further solidifying its market position and brand value.

3. Development instruments of enterprise

Certain research indicates that the correlation between ownership concentration and substantive innovation behavior does not adhere to a continuous proportionality; instead, it exhibits an inverted U-shaped relationship (Guang, 2024). Corporate governance frameworks, encompassing ownership concentration, board composition, and management hierarchy, constitute pivotal factors influencing the substantive innovation endeavors of enterprises. A tightly controlled diversity within these structures is instrumental in minimizing decision-making disparities, facilitating swift decision-making processes, and ensuring efficient resource allocation, thereby enhancing innovation capabilities. This stems from the motivation of major shareholders to exert control over corporate operations and safeguard their long-term interests. Conversely, excessively high levels of ownership concentration can foster managerial short-sightedness, thereby impeding innovation. Moreover, the relationship between board size and innovation behavior also manifests as an inverted U-shape. Smaller boards may constrain innovation due to resource limitations, whereas larger boards encounter challenges related to reduced agility and an overabundance of strategic decision-making processes, exacerbating complexities and hindrances in divergent communication. Additionally, within larger boards, the divergence of perspectives tends to stifle the formulation and implementation of innovative policies. Notably, the influence of larger board sizes on innovation behavior is nuanced and multifaceted:

1) Decision: complex decision-making, more commission cost and less efficiency will detract developers from being flexible or responsive in innovation.
2) Opinion Divergence - This can happen when the board is composed of members with varied backgrounds and interests, which may result in conflicting opinions that make it difficult to attain consensus and apply less conventional strategies.
3) Dilution Of Responsibility: In large boards, individual board members can feel less accountable, which may result in their focus wandering away from the most innovative projects.
4) Complex resource allocation: Complexities in deploying resources, especially when working on innovative projects (sometimes leads to less allocation and thus lesser innovation).

3.1. Channels through which corporate governance structures affect innovation behavior

1) Corporate Culture: A culture of transparency, and a supportive culture for innovation naturally spurs thoughts. Conversely, a conservative or risk-adverse culture will discourage innovation.
2) Category: Resource allocation Cash flow solutions require sufficient and reasonable resource allocation, which is the main driver of innovation. Lack of resources may hinder innovation.
3) Management Support: Innovation needs active support and participation of management. It improves employee morale and motivation, which leads to creative behavior.
4) Market turbulence: Changes in the market and competition drive innovation, but change also brings uncertainty where risk leads to conservative behavior (Kamal and Sawsan, 2013), which means smaller investments in new products.

3.2. Influence relationship

1) From the perspective of equity structure, In the context of enterprises' business development, it is imperative to craft strategic arrangements that achieve a harmonious equilibrium in equity concentration (Ebaid, 2009). Specifically, enterprises should strive to avoid scenarios where a single shareholder exerts undue dominance, as such a concentration of power can potentially stifle innovation and hinder the overall improvement of innovation capabilities. By fostering a balanced equity structure, enterprises can create a conducive environment for diverse perspectives and collaborative decision-making, thereby enhancing their capacity for innovative thinking and execution. This approach is critical for driving sustained growth and maintaining a competitive edge in today's dynamic business landscape.
2) From a board structure perspective, enlarging the board size in enterprises can contribute significantly to enhancing their innovation capabilities. However, this enhancement is subject to a threshold; an overly enlarged board size can, to a certain extent, impede the execution of substantial innovation initiatives within these enterprises. With regard to the proportion of independent directors, a nuanced analysis of the sampled companies across their respective industrial domains reveals that in critical operational areas, a high concentration of independent directors can potentially hinder the implementation of innovative activities. Conversely, in non-critical areas, this influence remains relatively subdued. The underlying rationale for this dichotomy lies in the various stages of an enterprise's development. Specifically, as a company's products mature and stabilize in the market, the impact of independent directors on corporate decision-making tends to diminish. This shift in influence is due to the fact that as the enterprise matures, its strategic focus shifts from exploratory innovation to incremental improvements, thereby reducing the need for extensive oversight by independent directors.
3) From the perspective of management, the increase in compensation for senior management personnel may not significantly affect the innovation capability of the enterprise. Increasing the shareholding ratio of senior management personnel can promote the implementation of enterprise innovation activities, but the shareholding ratio must be controlled within a certain range (Chen and Johnny, 2014). When the shareholding ratio of senior management personnel is too high, it will actually have a negative impact on enterprise innovation.

3.3. Suggestions for countermeasures

1) Optimization of equity structure. Companies can optimize their equity structure, balance the interests of shareholders, and avoid situations where one shareholder dominates. Enterprises should appropriately diversify their equity to reduce the possibility of tunneling problems, protect the interests of small and medium-sized shareholders (Zhang, 2005), and provide sufficient financial support for the implementation of innovation activities. At the same time, enterprises can promote the diversified development of equity structures, introduce funds from institutional investors, diversify the equity of major shareholders, and establish effective balance mechanisms. Institutional investors have strong rationality in investment, which can avoid the problem of ineffective equity diversification, and also supervise the operation and management activities of enterprises, avoiding the problem of operators encroaching on the interests of enterprise owners.
2) Optimization of the board structure. Board members can provide scientific suggestions for the development of enterprises and also help them obtain broader resource support. In some key areas, enterprises should expand the size of their board of directors and promote internal diversification based on their actual situation. In terms of independent directors, with a focus on technological innovation in the industry, the role of independent directors is constantly decreasing. For enterprises in key areas, the proportion of independent directors should be appropriately reduced.
3) Optimization of management incentives. Enterprises should appropriately increase the shareholding ratio of senior management personnel (Araldo et al., 2019). Although this may trigger a corresponding "trench defense effect", currently, the shareholding ratio of middle and senior management personnel in enterprises is generally small. Even if their shareholding ratio is significantly increased, it will not pose a threat to the interests of enterprise owners. In addition, equity incentives have a greater impact on innovation activities in key enterprises. Therefore, in management incentives, large listed enterprises should focus on equity incentive policies, while non other enterprises should pay attention to salary incentive policies.
4) Optimization of governance structure. Enterprises should optimize their governance structure based on their actual situation, improve information management and disclosure mechanisms, increase investment in innovation funds and talents, in order to obtain higher market evaluations and improve investment efficiency. Enterprises should introduce advanced management concepts, establish ecological and environmental awareness, actively assume corresponding social responsibilities, and effectively carry out internal governance work to achieve high-quality development.

4. Conclusion

The article explores the symbiotic relationship between corporate governance structures and the innovation capabilities of enterprises, it highlights that a well-crafted governance framework is not only pivotal for internal management and stakeholder accountability but also a catalyst for fostering an environment ripe for innovation and elucidates how different governance models can significantly influence strategic orientation, market adaptability, and organizational culture, thereby shaping the innovation landscape of a company. It presented underscores the nuanced impact of factors such as ownership concentration, board composition, and executive compensation on innovation. It reveals an inverted U-shaped relationship between these elements and innovation, suggesting a delicate balance is required to harness their full potential. The article advocates for a governance structure that promotes stakeholder harmony, risk resilience, and strategic agility to

drive innovation. Furthermore, offers pragmatic recommendations for enterprises to enhance their governance structures. These include optimizing equity distribution to prevent dominance by a single shareholder, refining board structures to encourage diverse perspectives, and aligning management incentives with innovation goals. By doing so, companies can create a robust foundation for substantive innovation, leading to improved performance and a competitive edge in the market. The article explores the symbiotic relationship between corporate governance structures and the innovation capabilities of enterprises, it highlights that a well-crafted governance framework is not only pivotal for internal management and stakeholder accountability but also a catalyst for fostering an environment ripe for innovation and elucidates how different governance models can significantly influence strategic orientation, market adaptability, and organizational culture, thereby shaping the innovation landscape of a company. It presented underscores the nuanced impact of factors such as ownership concentration, board composition, and executive compensation on innovation. It reveals an inverted U-shaped relationship between these elements and innovation, suggesting a delicate balance is required to harness their full potential. The article advocates for a governance structure that promotes stakeholder harmony, risk resilience, and strategic agility to drive innovation. Furthermore, offers pragmatic recommendations for enterprises to enhance their governance structures. These include optimizing equity distribution to prevent dominance by a single shareholder, refining board structures to encourage diverse perspectives, and aligning management incentives with innovation goals. By doing so, companies can create a robust foundation for substantive innovation, leading to improved performance and a competitive edge in the market. The article explores the symbiotic relationship between corporate governance structures and the innovation capabilities of enterprises, it highlights that a well-crafted governance framework is not only pivotal for internal management and stakeholder accountability but also a catalyst for fostering an environment ripe for innovation and elucidates how different governance models can significantly influence strategic orientation, market adaptability, and organizational culture, thereby shaping the innovation landscape of a company. It presented underscores the nuanced impact of factors such as ownership concentration, board composition, and executive compensation on innovation. It reveals an inverted U-shaped relationship between these elements and innovation, suggesting a delicate balance is required to harness their full potential. The article advocates for a governance structure that promotes stakeholder harmony, risk resilience, and strategic agility to drive innovation. Furthermore, offers pragmatic recommendations for enterprises to enhance their governance structures. These include optimizing equity distribution to prevent dominance by a single shareholder, refining board structures to encourage diverse perspectives, and aligning management incentives with innovation goals. By doing so, companies can create a robust foundation for substantive innovation, leading to improved performance and a competitive edge in the market. The article explores the symbiotic relationship between corporate governance structures and the innovation capabilities of enterprises, it highlights that a well-crafted governance framework is not only pivotal for internal management and stakeholder accountability but also a catalyst for fostering an environment ripe for innovation and elucidates how different governance models can significantly influence strategic orientation, market adaptability, and organizational culture, thereby shaping the innovation landscape of a company. It presented underscores the nuanced impact of factors such as ownership concentration, board composition, and executive compensation on innovation. It reveals an inverted U-shaped relationship between these elements and innovation, suggesting a delicate balance is required to harness their full potential. The article advocates for a governance structure that promotes stakeholder harmony, risk resilience, and strategic agility to drive innovation. Furthermore, offers pragmatic recommendations for enterprises to enhance their governance structures. These include optimizing equity distribution to prevent dominance by a single shareholder, refining board structures to encourage diverse perspectives, and aligning management incentives with innovation goals. By doing so, companies can create a

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