The Impact Of Internal Corporate Governance Mechanisms on Financial Performance of Iraqi Stock Exchange

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ABSTRACT

This paper examines the financial impact of the mechanisms of internal corporate governance in the context of the Iraqi Stock Exchange (ISX). A quantitative research design was selected to answer the research questions and five hypotheses. Sixty items were used to measure the effects of the internal corporate governance mechanisms on the financial performance of the ISX. A sample consisting of Iraqi Stock Exchange branches was chosen using the standardized random sample technique. The data analysis using SPSS version 25 and SmartPLS 3.28 showed the positive impact of the internal corporate governance mechanisms on the financial performance of the ISX. This result showed the significance of Board Committees in improving financial performance (beta=0.137; t=4.343; p<0.001). Likewise, the result also showed the significant impact of Board of Directors on financial performance (beta=0.217; t=7.771; p<0.000). Financial Statements & Auditors also pose a major significant impact on financial performance (beta=0.296; t=6.508; p<0.000), as does Ownership Structure (beta=0.209; t=4.607; p<0.000). Lastly, Stock-Based Compensation was also shown to pose an impact on financial performance (beta=0.167; t=3.389; p<0.001). This study's practical contribution is in addressing the weak financial performance of Iraqi commercial companies and urging the adoption of internal governance elements to solve the problems between management and shareholders, which helps reduce risks and corporate collapse as well as boost financial performance.

Keywords*: Corporate Governance, Internal Corporate Governance, Financial performance and Iraqi Stock Exchange*

1. INTRODUCTION

Foreign initiatives to change corporate governance were followed by well-publicized cases of significant corporate failures, most notably in emerging economies in the 1980s, particularly in the United Kingdom and the United States [1] There was pervasive concern that weak corporate governance policies had played a crucial role in triggering these market failures[2]. The UK responded to the situation by setting up the Cadbury Committee in 1991 and releasing its Best Corporate Governance Standards Guidelines for UK-listed businesses in 1992. Also in 1992, a voluntary initiative known as the King Committee on Corporate Governance was developed as initiated by the Southern African Institute of Directors, which received great domestic and foreign corporate governance interests[3]. Coined after its founder, Mervyn King, the committee primarily aims to find ways to drive the best practices in corporate governance in the context of South Africa[4].

Many countries across the globe, led by advanced nations, have made various attempts to increase their governance systems' performance by creating corporate governance guidelines and adopting corporate governance practices. The OECD has published globally recognized corporate governance principles. As a consequence, every country relies on good corporate governance practices to grow confidence towards their economy i.e. by showing equal and open policies and regulations for the safety of consumers and clients, as well as to test competent dedication to governing[5]. While the Middle Eastern nations were not resistant to the global financial crisis, the region's corporate governance structures are inextricably related to the equity markets' growth. Except for the Egyptian Stock Exchange, which was established in the 19th century, most of the recently developed financial markets in the Middle East were established in the 19th century[6]. In the past, in order to promote corporate governance practices among listed companies, stock exchanges were central. The value of exchanges in fostering good corporate governance results in the Middle East and the key support of exchanges in the implementation of participation, transparency, and compliance reporting requirements[7]. The listed companies are substantially influenced by the changing regulatory requirements, especially those related to corporate governance laws[8].

Corporate governance systems in developing markets frequently replicate those in developed economies, although not in nature[9]. The Iraqi Stock Exchange (ISX) is the major focus of the Iraqi financial market. Its capital exchange is limited and underdeveloped in comparison to that of other Middle East nations. It works in isolated forms and exchanges business shares in the main and secondary markets. According to ISX (2016), the capital market was established in 2004.

In comparison to the Corporate Governance Code or Corporate Governance Standards of the Middle East, the ISX struggles with the non-application or adoption of corporate governance laws or guidance[10]. Iraq's low foreign business integration insulated it from the global financial crises' immediate effects on the country's financial sector. On the other hand, the non-integration had posed a negative impact on Iraq's economy which relies on oil for four out of every five dollars[11]. There will be greater employment opportunities, improved oil price stability, and better opportunities for the future generations when the economy is more diversified and expenditure is higher, particularly outside of the hydrocarbon industry. It will also diversify the government's revenue source, reduce oil dependence, and make the economy more responsive to price fluctuations. If properly handled, they will also produce financial profits that can be used to boost human and material resources and, in exchange, support further private investment[12].

Only a few researchers had focused on the value contributed by corporate governance and its impact in driving investment into Iraq. Likewise, only a few studies had reviewed Corporate Governance 5's internal processes and their effect on the activities of companies listed on the Iraqi stock exchange. The economies of developing nations and broad emerging economies are the subject of these corporate governance studies. Furthermore, there is scarce research on governance philosophy and its role in drawing in investments, corporate governance structures, or other facets of corporate governance mechanisms, thus suggesting that the theory of governance is new to Iraqi governance. The topic of corporate finance and accounting disclosures is discussed in one research[13]. Meanwhile, the financial factor and financial results regarding the link between accounting disclosures and corporate governance are addressed in another[14].

This research aims to determine internal governance structures and their effect on the financial results of ISX-listed companies by looking at the different sectors in the Iraqi economy and assessing if there are any discrepancies among them. Consequently, the analysis queries in this research include: "How does the governance of the listed companies on the Iraqi Stock Exchange (ISX) affect their financial performance?" And, according to the Board of Directors, Board Committees, Financial Statements & Auditors, Stock-Based Compensation and Company Ownership Structure: "Are there any distinctions between the principles of internal corporate governance?"

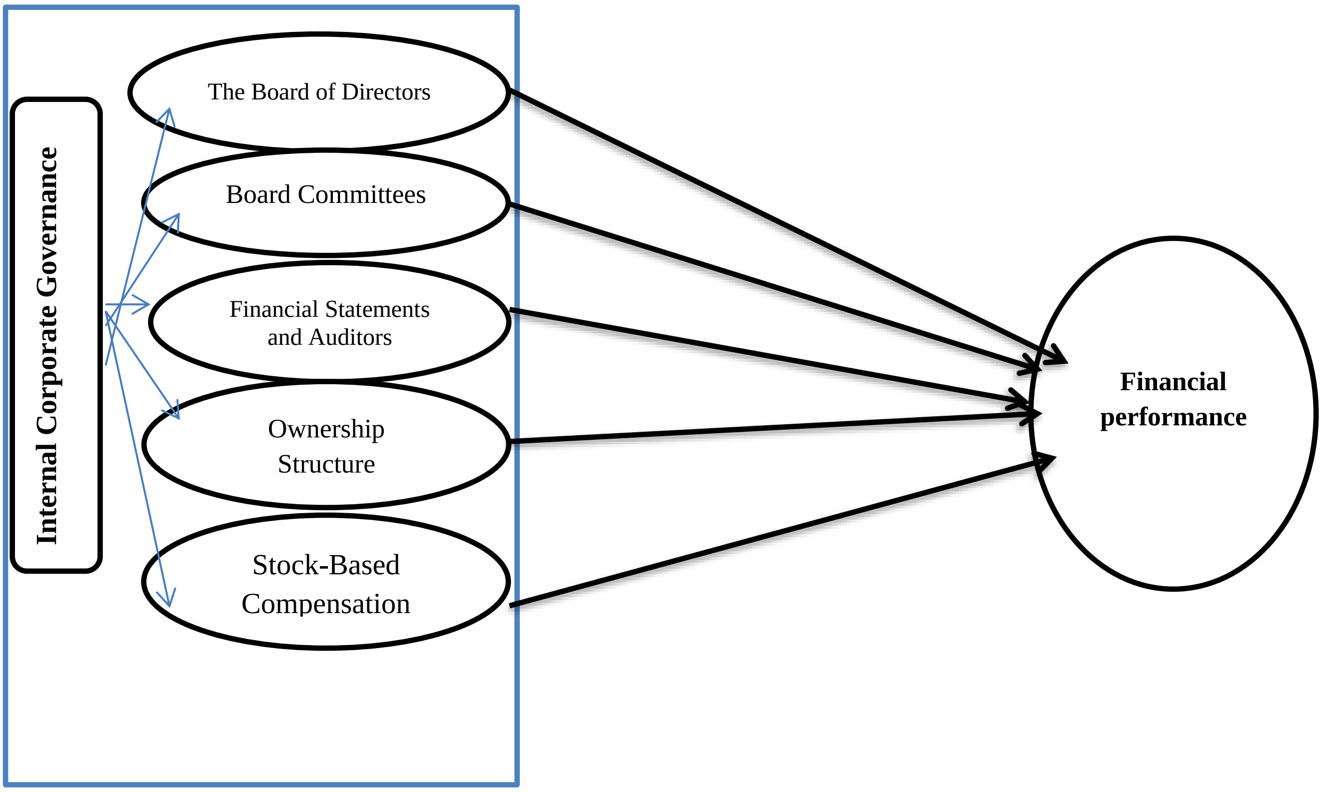

Figure 1: Conceptual Framework

1.2 The Motivation of Study

There are three key factors behind the new analysis of Iraq. First and as quickly mentioned above, Iraq possibly presents an important research framework where it is possible to empirically analyze internal corporate governance of financial output associations. In fact, Iraq's business climate shares a certain degree of parallels and disparities with the corporate background of the Arab countries.

2. LITERATURE REVIEW

2.1 Corporate Governance

The inadequate and vague definition of corporate governance happened due to the distinct national systems in various jurisdictions[12]. However, it has been universally agreed that corporate governance plays a role to delegate the tasks and resources within the company to conduct strategic actions to create value and a positive image to the particular entity and across various countries[15]. In simpler words, corporate governance is a process whereby an organization is controlled to create a surrounding with trust, transparency, and accountability[12]. There are broad and narrow views of corporate governance. Based on the narrow perspective, corporate governance only concentrates on the company-shareholder relationship to ensure that the company's business runs according to the shareholders' interest with a lesser emphasis on financial performance[16].

In general, the research's corporate governance principles tend to have similar attributes, one of which is the principle of clarity. Narrow principles focus on corporate shareholder accountability[17]. The broader shareholder-based principles concentrates on the capability of a regulatory system to safeguard minority shareholders' rights. In general, corporate governance refers to the processes, customs, regulations, laws and systems controlling the operations, administration and management of organizations and businesses. It functions to fulfill an organization's purpose and retains stakeholder relationships, Boards of Directors and Investors are included[14].

2.2 Internal Corporate Governance Mechanisms

Corporate governance mechanisms can be characterized as the number of institutions and practices participating in these positions related to businesses[18]. It also refers to the procedures used by an organization to control corporate insiders and managers in order to protect their rights[19]. In particular, this entails the ownership structure and board of directors. Internal processes are the techniques and practices adopted by companies that assist management in maximizing shareholder value. Ownership structure, the board of directors, accounting boards, salary board, board committees, financial statements & auditors, and stock-based compensation are the components of internal mechanisms:

2.2.1 The Board of Directors: The Board of Directors entails the key individuals in a corporation or the cornerstones of the corporation. They have more corporate organization authorities and obligations and oversee and regulate all management operations in order to sustain business success on the track and safeguard the interests of stakeholders[20]. In comparison, the board of directors is morally liable for the choices they made on behalf of a business and they are also more encouraged to appoint a new member or employee for the company. They are strongly responsible for the financial reports given to them about the business at the time of the audit. Three kinds of directors are available: internal, external and autonomous directors. Internal directors operate inside the organization; external directors function from outside the corporation and work with many organizations on board, whilst autonomous directors objectively preserve their integrity and offer their own decision-making processes[21].

2.2.2 Board Committees: The board of trustees' additional component is the board committees. These committees carry out specifically delegated tasks as instructed by the board of directors, and are overseen by the organization's laws and regulations based on the industry it is in. If these types of committees' existence should be obligatory for the company or not depends solely on the laws and regulations of the region[22].

2.2.3 Financial Statements and Auditors: The financial statements are the data comprising the data and transactions of the organization. Each business to file its financial results on a quarterly and annual basis to have them approved by the auditors. The auditors' final image shows the organization's true financial image, which further becomes the data explicitly or implicitly with the parties concerned with the company. Stakeholders produce their declarations of action against the business based on these financial statements. If the results are considered to be optimistic, they make up their mind to invest in certain businesses, on the other hand, if the stakeholders see the study on the wrong side, it would further hamper their degree of confidence in support of the companies[23].

2.2.4 Ownership Structure: This is another method to handle the management portion of the organization. In this sense, for the best outcomes of all the organization's operations, an entity should maintain the greatest form of management and control[24].

2.2.5 Stock-Based Compensation: The only approach for eradicating the theory and the problem of agent costs is to provide workers with shareholder interest on schedule and fair pay. Stock-based pay allows owners to empower internal management to meet the company's long-term targets [20].

2.3 Corporate Governance in Iraq

Numerous surveys have been carried out to examine the prevailing corporate governance in industrialized and emerging countries. Nonetheless, such reports in the context of Iraq are scarce, whereby most existing ones only focus on the aspect of financial performance or disclosure and accountability[14]. In Iraq, it is imperative to adhere to corporate governance principles especially as the country is at the forefront of many prospects and challenges including those related to the economy; hence, it is necessary to establish an interconnected atmosphere of trust and rules to justify good corporate practices and to provide adequate assurances to obtain investors' interest to invest in companies [13].

In most developing countries, several studies related to corporate governance have been conducted. However, only a small amount of studies were done on this matter in the Iraqi environment. Most of them focused on the performance of their financial matter or on the aspects of disclosing the information. Even though it is essential to implement the corporate governance concept in Iraq, there is also a need to establish an atmosphere of cohesive rules and trust to elucidate good corporate governance practices among companies and to provide sufficient guarantees to gain the confidence of investors [13]. The nation is preparing itself for upcoming prospects and challenges particularly in the economic aspect. Furthermore, [5, 18, 21, 25] intended to give evidence of corporate governance implementation in the context of the regulatory and legal frameworks of ISX-listed companies. Therefore, several of their paragraphs correlate to the concepts established by international corporate governance to observe the impacts of the index development on the Iraqi market’s economic side, to mitigate the risk level of listed companies, to make a contribution to the market’s construction in line with market globalization requirements, and to provide a complete understanding of the shareholders . In his research, [11] found that thorough training in the idea of corporate governance is required since it will assist organizations in handling financial, accounting, as well as reporting issues amongst listed companies, particularly those with open financial reports.

2.4 Financial Performance

A company’s policies and operations are reflected by its financial performance, which generally measures the company’s comprehensive financial health for a given time period which can then be utilized as a comparative point against other companies of the same nature or between sectors and industries within the same market[25]. There are many common ways to estimate a company's financial results, among which are via its return on investment (ROI), return on assets (ROA), and return on sales

(ROS), all of which are subjective measures of how a company can utilize assets from its primary market mode and generate revenue [26]

In reference to the concept of performance, it is used to elaborate on the business performance that has the legal status of a company. Besides that, the performance of a firm can be explained as the result of the firm's strategy or assessment which had proven that there is a possibility for the firm to achieve its objectives[27]. Performance refers to a company's level of success in achieving its goals, mission and vision, based on its strategic planning. Meanwhile, financial performance refers to the company's level of success in achieving its corporate goals over a specific time period[26]. A company's financial performance can be determined by examining the numerous financial ratios derived from its financial statements. The numerous figures disclosed in the said financial statements are linked by the financial ratios[28].

2.5 Internal Corporate Governance Mechanisms and Financial Performance

[22]indicated that accumulation of ownership has the most important effect on governance and a negative impact on business success. On the contrary, ownership consolidation impedes the roles of the board of directors and the supervisory board, thus hindering them from improving the company's market performance. [29]stated that the degree of board independence is relevant, and that it seems to pose only positive impacts on the performance of larger organizations. In the context of China however, corporate financial success is not significantly affected by the experience of the supervisory board. Our results endorse a continuing emphasis on boosting the performance of corporate governance institutions in China. The analysis showed that there is an important positive association between the makeup of the board and ownership of management with the financial results of Nigerian businesses. There is a major negative association between the Nigerian businesses' financial results and the scales of block ownership, audit committee, and chairman/CEO duality[30]. Therefore, with five respective theories, this report pioneers the analytical analysis of these significant issues:

H_1. The Board of Directors poses a major impact on the Iraqi commercial firms' financial performance.

H_2. The Board Committees pose a major impact on the Iraqi commercial firms' financial performance.

H_3. Financial Statements & Auditors pose a major impact on the Iraqi commercial firms' financial performance.

H_4. Ownership Structure poses a major impact on the Iraqi commercial firms' financial performance.

H_5. Stock-Based Compensation poses a major impact on the Iraqi commercial firms' financial performance.

2.6 Agency Theory

The agency philosophy represents the collection of principal-agent issues that can occur as a consequence of the company's complex set of contracts[31]. In the separation of control from administrators, these contracts may be either tacit or implied. The most well-known of these principal-agent issues arise where owners and managers have conflicting desires, causing the failure of the agent (management) in improving principal's (shareholders) well-being [23]. But the principal-agent issue often occur as a consequence of perceived differences in the priorities of multiple resource suppliers to the enterprise, as well as the distinction of risk-bearing, decision-making, and management functions[27]. Consequently, the agency theory serves as the analytical perspective that underpins this study's conceptual model, specifically the measures of board membership and type of ownership.

3. METHODOLOGY

The current study employs the survey research design. The study population entails Iraqi commercial corporations. The sample size was determined using the stratified random sampling technique. The number of respondents involved in this study is 175. Data was collected using questionnaires. The data was analyzed using the Assessment Measurement Model. The Structural Model Assessment was utilized for estimating the causal relationship between the internal corporate governance mechanisms and the Iraqi commercial firms' financial performance. A total of 150 questionnaires were retrieved and determined to be valid for statistical analysis purposes, recording a return rate of 86% out of the total distributed questionnaires. The Statistical Package for Social Sciences (SPSS 26) and Smart-PLS 3.3 were used to code and analyse the variables. The analysis results are presented in the subsequent section.

4. RESULT AND DISCUSSIONS

4.1 Assessment Measurement Model

The latent variables must be explicitly calculated by the things hired. The objects were then subjected to many checks as follows: durability, the validity of discriminants, and validity of convergent. As the findings obtained have demonstrated, the estimation models all follow the minimum criteria (see Table 2). In fact, loadings higher than 0.741 were obtained for all products. As indicated in[32], higher-level loading factors for external loading factors denote greater-level indicator reliability. In addition, the alpha and composite reliability of Cronbach, rhoA, produce more reliable data accuracy predictions, and the obtained values indicate the reliability of the items loaded on each of the constructs in this analysis[33]. In addition, the average variance extracted (AVE) values obtained were all higher than the threshold of 0.50, and the values were focused on [34]in favor of the convergent validity of the build measurements. In summarized form, the calculation model is shown in Table 2.

Table 2:

Measurement Model

	Cronbach's Alpha	rho_A	Composite Reliability	Average Variance Extracted (AVE)
Board Committees	0.982	0.985	0.984	0.859
Board of Directors	0.976	0.980	0.979	0.840
Financial Performance	0.972	0.975	0.976	0.818
Financial Statements & Auditors	0.981	0.983	0.983	0.855
Ownership Structure	0.977	0.981	0.980	0.845
Stock-Based Compensation	0.988	0.998	0.989	0.909

Table 3 demonstrates the latent variable interaction between both factors. Fornell-Larcker's has been the most prominent method for determining the extent of interaction between latent variables. The table indicates that the relationship between each vector is horizontally and vertically important to itself. Horizontally and vertically, the Board Committees vector is the largest. Furthermore, horizontally and vertically, Accounting Statements & Auditors are the best. It should be noted that, since each variable reached the value of 0.70, the latent variable predictor is also significant. Furthermore, the relationship between the horizontal ownership framework and financial results is significant. Horizontally and vertically, Stock-based Incentives, the Board of Directors and Board Committees are all relevant. The latent variable, however, revealed the effect between the variables.

Table 3.

Latent Variable Correlations (Fornell-Larcker criteria)

	Board Committees	Board of Directors	Financial Performance	Financial Statements & Auditors	Ownership Structure	Stock-Based Compensation
Board Committees	0.927					
Board of Directors	0.126	0.917				
Financial Performance	0.299	0.418	0.904			
Financial Statements & Auditors	0.285	0.390	0.521	0.925		
Ownership Structure	0.062	0.150	0.310	0.201	0.919	
Stock-Based Compensation	0.221	0.224	0.352	0.357	0.005	0.953

Cross Loading

Table 1 shows that in the - column, each object is important. Objects in the model load heavily on their own structures. The cross-loading reveals that, among other things, the items have major results in each column in the same vector. For both products, cross-loading happens, but clean loading is the challenge. Greater values have been achieved amongst the items. Table 1 shows that the cross-loading for the Board Committees variable is from 0.902 to 0.947. Additionally, the Board of Directors variable shows a cross-loading value of between 0.844 and 0.956; Financial Performance of between 0.836 and 0.939; Financial Statements & Auditors of between 0.883 and 0.960; Ownership Structure of between 0.856 and 0.945, and finally Stock-Based Compensation of between 0.932 and 0.967. Moreover, cross-loading is from 0.836 to 0.967.

Table 1.

Cross Loading

	Board Committees	Board of Directors	Financial Performance	Financial Statements & Auditors	Ownership Structure	Stock-Based Compensation
BC1	0.940					
BC10	0.932					
BC2	0.919					
BC3	0.908					
BC4	0.904					
BC5	0.902					
BC6	0.947					
BC7	0.936					
BC8	0.941					
BC9	0.939					
BD1		0.844				
BD10		0.932				
BD2		0.895				
BD3		0.918				
BD4		0.895				
BD6		0.956				
BD7		0.934				
BD8		0.923				
BD9		0.946				
FP10			0.907			
FP2			0.936			
FP3			0.896			
FP4			0.836			
FP5			0.893			
FP6			0.924			
FP7			0.906			
FP8			0.898			
FP9			0.939			
FS&A1				0.960		
FS&A10				0.937		
FS&A2				0.892		
FS&A3				0.883		
FS&A4				0.927		
FS&A5				0.915		

FS&A6				0.926		
FS&A7				0.938		
FS&A8				0.945		
FS&A9				0.919		
OS1					0.942	
OS10					0.936	
OS2					0.938	
OS3					0.856	
OS4					0.903	
OS5					0.895	
OS7					0.933	
OS8					0.924	
OS9					0.945	
SBC1						0.937
SBC2						0.932
SBC3						0.953
SBC4						0.956
SBC5						0.962
SBC6						0.960
SBC7						0.954
SBC8						0.958
SBC9						0.967

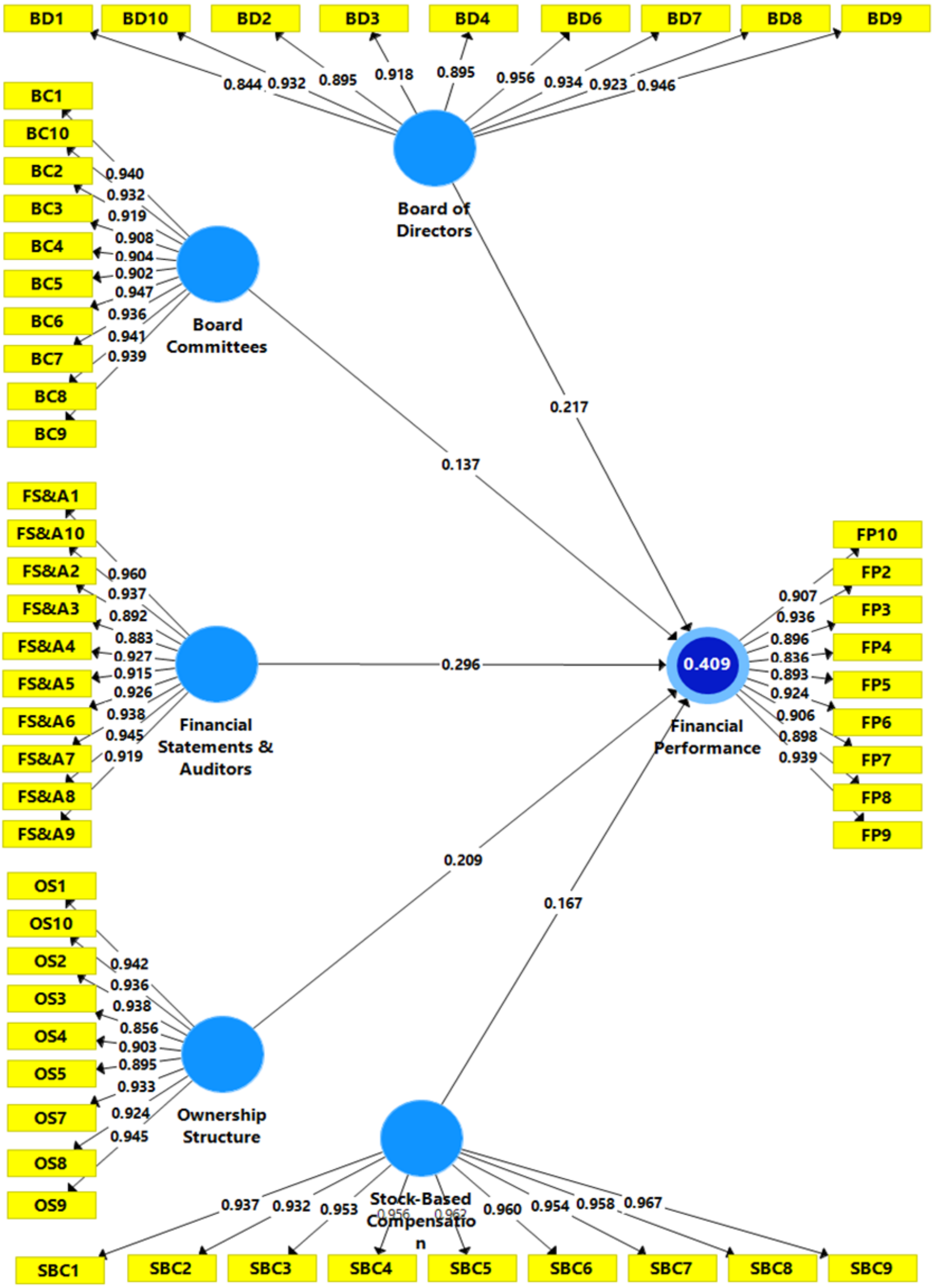

Figure 2: **Structural Model of the Study**

4.2 Assessment of Structural Model

In this study, data analysis and hypothesis testing were carried out using SmartPLS. The analysis entailed the determination of the convergent and discriminant validity, latent variable (Fornell-Lacker Coefficient), and R2 a. In this section, the path coefficient is explained, focusing on the direct hypotheses. It also focuses on the model and the discussion of the study.

The subsequent move in SEM-PLS is structural model evaluation, as shown in Figure 3. The results clarifying the structural model are presented in Table 4 and Figure

3. The value of the R square is 0.40, indicating that 40 percent of the dependent variable variation is explained by the model variable (Cohen, 1988). Hypothesis 1 proposes the significant link between Board Committees and Financial Performance, and the finding supports it (beta=0.137; t=4.343; p<0.001). This finding shows that the variable of Board Committees significantly affects Financial Performance, hence supporting H1. Likewise, the variable of Board of Directors also has a significant effect on Financial Performance (beta=0.217; t=7.771; p<0.000), thus supporting H2. Consistently, the variable of Financial Statements & Auditors also has a significant effect on Financial Performance (beta=0.296; t=6.508; p<0.000), hence supporting H3. The variable of Ownership Structure is also found to have a significant impact on Financial Performance (beta=0.209; t=4.607; p<0.000), thus supporting H4. Finally, the variable of Stock-Based Compensation also significantly affects Financial Performance (beta=0.167; t=3.389; p<0.001), hence supporting H5.

Table 4 :

Hypothesis testing

	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (|O/STDEV|)	P Values
Board Committees -> Financial Performance	0.137	0.139	0.041	3.377	0.001
Board of Directors -> Financial Performance	0.217	0.217	0.050	4.343	0.000
Financial Statements & Auditors -> Financial Performance	0.296	0.294	0.045	6.508	0.000
Ownership Structure -> Financial Performance	0.209	0.207	0.045	4.607	0.000
Stock-Based Compensation -> Financial Performance	0.167	0.169	0.049	3.389	0.001

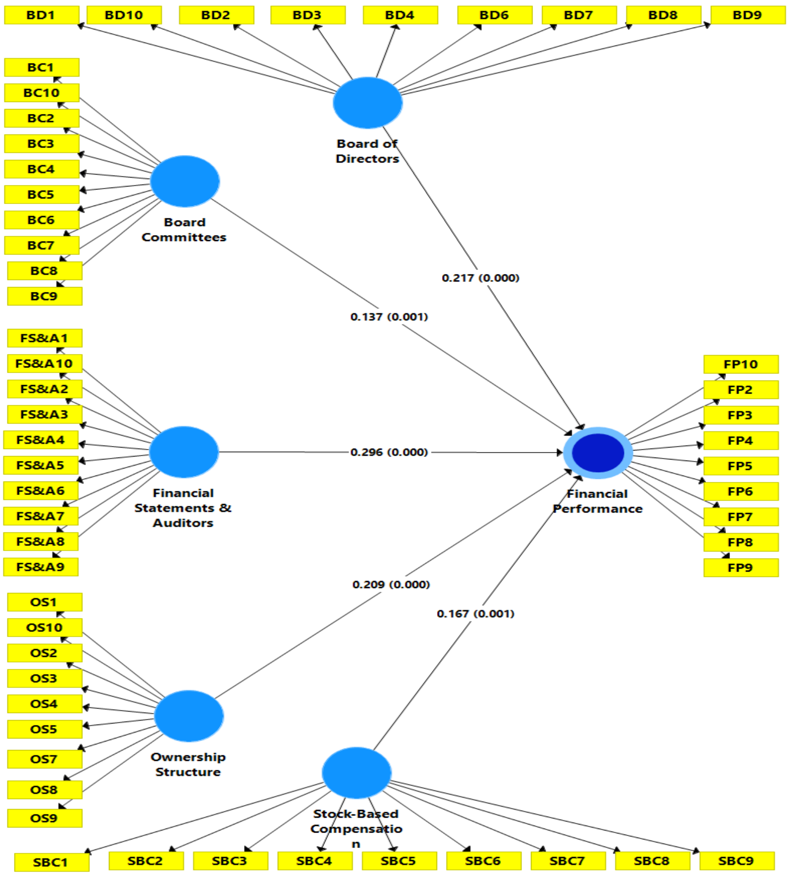

Figure 3: Coefficient of Determination R2

Figure 3 presents the R2 for the financial performance variable. According to[35], the results show moderate effects. Thus, the R2 effects value of 0.409 is high according to[36]. R2 adjusted is 0.401, which is also high.

5. Conclusion

The effect between Internal Corporate Governance structures on financial results would remain essential issues in the light of rivalry and the advent of emerging technology and commercial services. With technical advancements in commercial enterprises, market management has become the most significant and daunting obstacle for commercial enterprises, hence their financial success is critical and an important overall priority for all decision-makers of commercial enterprises in developed countries, including in Iraq. Mechanisms for internal corporate governance have been generally accepted as one of the most important variables in achieving commercial productivity and rising competitiveness in commercial firms.

This study concluded that Hypothesis 1 which suggests that the variable of Board Committees has a significant effect on Financial Performance is supported based on the result in Table 4 and Figure 3 (beta=0.137; t=4.343; p<0.001). The result indicates that Board Committees significantly improve Financial Performance, hence supporting H1. Likewise, the variable of Board of Directors also has a significant effect on Financial Performance (beta=0.217; t=7.771; p<0.000), thus supporting H2. The variable of Financial Statements & Auditors is also found to have a significant effect on Financial Performance (beta=0.296; t=6.508; p<0.000), hence supporting H3. Similarly, Ownership Structure has a significant effect on Financial Performance (beta=0.209; t=4.607; p<0.000), thus H4 is accepted. Finally, Stock-Based Compensation also has a significant impact on Financial Performance (beta=0.167; t=3.389; p<0.001), hence

H5 is accepted. With this work, we cover one of the gaps detected in the literature concerning the impact of internal corporate governance mechanisms on the Iraqi stock market, specifically on commercial companies.

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