

**AGENCY CONFLICTS AND THEIR RELATIONSHIPS
TO FIRMS PERFORMANCE IN JORDAN**

QUTAIBA KHALED ABDU ALKHAZALEH

UNIVERSITI SAINS MALAYSIA

2024

AGENCY CONFLICTS AND THEIR RELATIONSHIPS TO FIRMS PERFORMANCE IN JORDAN

by

QUTAIBA KHALED ABDU ALKHAZALEH

Thesis submitted in fulfilment of the requirements
for the degree of
Doctor of Philosophy

January 2024

ACKNOWLEDGEMENT

Foremost, I would like to express my gratitude to ALLAH ALMIGHTY for his protection and divine guidance. Praise be to ALLAH. Secondly, I would like to express my heartfelt gratitude to my main supervisor Dr. Amirul Shah MD Shahbudin, my co-supervisor and former main supervisor Dr. Aziatul Waznah, and my former co-supervisor Dr. Sarini Binti Azizan. It would have been impossible to conduct this research without their support, advice, and help made by them. May Allah bless you all. Besides my supervisors, I would like to thank my thesis committee for their valuable time to evaluate my thesis. Third, I would like also to express my sincere gratitude to my lovely family; my father Professor Khaled for his moral and financial support, and my mother for the continuous Dua'a for me. In addition, I would like to thank my siblings Huthifa, Abdullah, and Yaqen for their support. Special thanks should be extended to my lovely fiancée for supporting me spiritually throughout my doctoral journey. Last but by no means least, I would like to thank the staff of USM, particularly, the staff of the school of management for allowing me the chance to learn through the proper process.

TABLE OF CONTENTS

ACKNOWLEDGEMENT	ii
TABLE OF CONTENTS.....	iii
LIST OF TABLES	vii
LIST OF ABBREVIATIONS	viii
ABSTRAK	x
ABSTRACT	xii
CHAPTER 1 INTRODUCTION.....	1
1.1 Chatper overview	1
1.2 Background of Study.....	1
1.3 Research Problem.....	9
1.4 Research Questions	17
1.5 Research Objectives	17
1.6 Scope of Study	18
1.7 Significance of Study	20
1.8 Definition of Variables.....	22
1.9 Organization of The Thesis	22
CHAPTER 2 LITERATURE REVIEW.....	23
2.1 Chapter overview	23
2.2 Firm performance	23
2.2.1 Financial Performance	25
2.3 Firm Investment Efficiency.....	28
2.4 The Relationship between Earnings Quality and Firm Performance	33
2.5 The Relationship between Earnings Quality and Investment Efficiency.....	42
2.6 Corporate Governance Mechanisms	48
2.6.1 Overview of Corporate Governance in Jordan	48

2.6.2	Ownership Structure	50
2.6.2.(a)	The Relationship between Concentration Ownership and Firm Performance	51
2.6.2.(b)	The Relationship Between Concentration Ownership and Investment Efficiency	56
2.6.2.(c)	The Relationship Between Managerial Ownership and Firm Performance	58
2.6.2.(d)	The Relationship Between Managerial Ownership and Investment Efficiency	62
2.6.3	Board Composition	64
2.6.3.(a)	The Relationship Between Board Independence and Firm Performance	65
2.6.3.(b)	The Relationship Between Board Independence and Investment Efficiency	69
2.7	The Relationship Between Investment Efficiency and Firm Performance	72
2.8	Control Variables	74
2.9	Summary of Chapter	77
CHAPTER 3 FRAMEWORK AND HYPOTHESES DEVELOPMENT		78
3.1	Chapter overview	78
3.2	Theories	78
3.2.1	Agency Theory	78
3.3	Framework of Study	82
3.4	Hypotheses Development.....	83
3.5	Summary of Chapter	100
CHAPTER 4 METHODOLOGY.....		102
4.1	Chapter overview	102
4.2	Research Design.....	102
4.3	Unit Analysis.....	103
4.4	Population of the Study	103
4.5	Sources of Data	105

4.6	Model of Specification	105
4.7	Measurement of Variables	108
4.8	Analysis Data Techniques	115
4.9	Summary of Chapter	117
CHAPTER 5 ANALYSIS AND FINDINGS		118
5.1	Chapter Overview	118
5.2	Overview of Data Collection.....	118
5.3	Descriptive Statistics of Variables	118
5.4	Hausman Test.....	121
5.5	Diagnostic Test.....	122
5.6	The Results of hypothesis Testing	129
5.6.1	The Results of Relationship between Earnings quality, Corporate Governance, and Firm Performance.....	130
5.6.2	The Results of Relationship between Earnings quality, Corporate Governance, and Investment efficiency.	131
5.6.3	The Results of Relationship between Investment Efficiency and Firm Performance	133
5.6.4	The Results of the Mediating Role of Investment Efficiency Relationship between Earnings quality, Corporate Governance, and Firm Performance	134
5.7	Summary of the Chapter	138
CHAPTER 6 DISCUSSION AND CONCLUSION		139
6.1	Chapter overview	139
6.2	Recapitulation.....	139
6.3	Discussion of Analysis and Findings	143
6.4	Contributions from the Undertaken Research	161
6.5	Limitations	164
6.6	Suggestions for Future Studies.....	164
5.7	Conclusion.....	165

REFERENCES.....	167
------------------------	------------

APPENDICES

LIST OF TABLES

	Page
Table 1.1 Gross Domestic Product and Labour Force by Sectors	19
Table 4.1 Population of the Study	104
Table 4.2 Description of Measurements	107
Table 4.3 Corporate Governance Mechanisms Measurements.....	111
Table 5.1 Descriptive Statistics.....	119
Table 5.2 The Results of Hausman Test	121
Table 5.3 Skewness/ Kurtosis for Normality Test	122
Table 5.4 Unit Root Test.....	124
Table 5.5 The Results of Correlation Matrix	124
Table 5.6 The Results of VIF	125
Table 5.7 The Results of Wald Test.....	126
Table 5.8 The Results of Wooldridge	127
Table 5.9 The Results of the Relationship between Earnings quality, Corporate Governance, and Firm Performance	130
Table 5.10 The Results of the Relationship between Earnings Quality, Corporate Governance, and Investment Efficiency	132
Table 5.11 The Results of the Relationship between Investment Efficiency and Firm Performance.....	133
Table 5.12 The Mediating Role of Investment Efficiency on The Relationship between Earnings Quality, Corporate Governance, and Firm Performance	135
Table 5.13 Sobel Test.....	136

LIST OF ABBREVIATIONS

IMF	International Monetary Fund
EU	European Union
GDP	Gross Domestic Product
ASE	Amman Stock Exchange
ROA	Return on Assets
ROE	Return on Equity
ROI	Return on Investment
GAAP	Generally Accepted Accounting Principles
MENA	Middle East and North Africa
GCC	Gulf Cooperation Council
MVA	Market Value Added
MTB	Market Value of firm to the book value of firm
EVA	Economic Value Added
EBIT	Earnings Before Interest and Taxes
PCSE	Panel Corrected Standard Error

KONFLIK AGENSI DAN HUBUNGANNYA DENGAN PRESTASI FIRMA DI JORDAN

ABSTRAK

Krisis yang mempengaruhi ekonomi negara Jordan telah menyebabkan firma negara tersebut telah terkesan dan prihatin terhadap isu-isu pelaburan and prestasi syarikat. Pelbagai arahan dan pekeliling telah dikeluarkan oleh Bursa Saham Amman yang berusaha menyokong serta mengawalselia terhadap prestasi firma. Usaha-usaha ini membawa kesan positif terhadap firma Jordan dalam meningkatkan keperihatinan mereka terhadap kualiti pendapatan, dan tadbir urus. Kajian ini menjurus kepada dua faktor penting yang mempengaruhi prestasi firma, iaitu kualiti pendapatan, dan tadbir urus. Kajian ini mempunyai empat objektif utama. Pertama, mengkaji hubungan langsung di antara kualiti pendapatan, pentadbiran korporat dan prestasi firma. Kedua, untuk mengkaji hubungan tidak langsung antara kualiti pendapatan, pentadbiran korporat dan keberkesanan pelaburan. Ketiga, untuk mengkaji hubungan tidak langsung antara keberkesanan pelaburan dan prestasi firma. Keempat, untuk mengkaji hubungan tidak langsung antara kualiti pendapatan, pentadbiran korporat dan prestasi syarikat; dengan keberkesanan pelaburan sebagai pengantara. Berdasarkan teori agensi, kajian ini berhasrat untuk mengenal pasti bagaimana kualiti pendapatan, dan tadbir urus dapat meningkatkan prestasi firma melalui keberkesanan pelaburan sebagai mediator pembolehubah. Untuk mencapai objektif-objektif kajian ini, kajian akan menggunakan analisis kandungan laporan tahunan firma yang tersenarai dalam Bursa Saham Amman untuk tahun 2012 sehingga 2019. Data telah dianalisis dengan menggunakan perisian STATA. Kajian ini membina kualiti pendapatan berdasarkan tiga unit perakaunan atau sifat-sifat pendapatan dari kajian-kajian lain, iaitu kelangsungan pendapatan, kelicinan

pendapatan dan keboleh-ramalan pendapatan. Tadbir urus telah diukur dengan struktur pemilikan dan komposisi lembaga pengarah. Keberkesanan pelaburan telah diukur dengan kepekaan pelaburan terhadap peluang pelaburan. Akhirnya, Tobin's Q telah digunakan untuk mengukur prestasi dan firma. Keputusan kajian ini mendedahkan terdapatnya hubungan positif yang signifikan dan bermakna di antara kelangsungan pendapatan, pengurusan pemilikan dan tumpuan pemilikan, dengan prestasi firma. Keputusan kajian ini juga menunjukkan bahawa terdapat hubungan positif yang signifikan dan bermakna di antara kelangsungan pendapatan, kelicinan pendapatan, pengurusan pemilikan dan tumpuan pemilikan, dengan keberkesanan pelaburan. Kualiti pendapatan yang tinggi membawa kepada prestasi firma yang tinggi di Jordan, di mana kualiti pendapatan mengurangkan kos agensi, telah mencerminkan secara positif prestasi firma Jordan. Selain itu, pengurusan pemilikan lebih berkesan dalam mengurangkan konflik agensi dan asimetri maklumat, dan pengurangan ini meningkatkan prestasi firma. Dalam nada yang sama, tumpuan pemilikan di negara membangun bertindak sebagai mekanisme pemantauan tindakan pengurusan yang cekap kerana pemegang saham yang besar boleh menjejaskan keputusan pengurusan berdasarkan kedudukan mereka. Dalam hal pengantaraan, kajian ini menggunakan kaedah Baron dan Kenny (1986), untuk menguji kesan pengantaraan. Keputusan menunjukkan bahawa keberkesanan pelaburan menjadi pengantara dalam hubungan diantara kelangsungan pendapatan, pengurusan pemilikan, tumpuan pemilikan, dan prestasi firma.

AGENCY CONFLICTS AND THEIR RELATIONSHIPS TO FIRMS PERFORMANCE IN JORDAN

ABSTRACT

The crises that influenced the Jordanian economy were a wake-up call for Jordanian firms and raised concerns on the issues of investment and performance. Various instructions and circulars have been issued by the Amman Stock Exchange as part of dedicated efforts to support firm's performance, resulting in Jordanian firms giving more critical attention to their earnings quality, and corporate governance. The present study focuses on two prominent factors that would affect firm performance, which are earnings quality and corporate governance. There are four main objectives of this study. First, to examine the direct relationship between earnings quality, corporate governance and firm performance. Second, to examine the relationship between earnings quality, corporate governance, and investment efficiency. Third, to examine the relationship between investment efficiency and firm performance. Fourth, to examine the indirect relationship between earnings quality, corporate governance and firm performance; with investment efficiency as a mediator. Based on the agency theory, the present study had identified how earnings quality, and corporate governance can enhance firm performance through investment efficiency as the mediator variable. To accomplish the objectives of this research, the present study had utilised content analysis of annual reports of 78 firms listed on the Amman Stock Market Exchange (ASE) for the years 2012 to 2019. Data had been analysed using STATA software. The current study constructed earnings quality based on three accounting measures of earnings attributes used in prior studies, namely, earnings persistence, earnings smoothness, and earnings predictability. Corporate governance

had been measured by managerial ownership, concentration ownership, and board independence. Investment efficiency had been measured by the sensitivity of investment to investment opportunities. Finally, Tobin's Q had been employed to measure firm performance. The results of this study revealed that there was a significant positive direct relationship between earnings persistence, managerial ownership and concentration ownership, with firm performance. Moreover, the results of this study showed that there was a significant positive relationship between earnings persistence, earnings smoothness, managerial ownership and concentration ownership, with investment efficiency. High earnings quality led to high firm performance in Jordanian firms, where earnings quality reduces agency cost, which was reflected positively on Jordanian firm performance. Also, Managerial ownership was more effective in mitigating agency conflict and information asymmetry, and this mitigating enhances firm performance. In the same vein, ownership concentration in developing countries acted as an efficient monitoring mechanism of management action as top shareholders can affect management's decision by virtue of their positions. In the field of mediation, the current study adopted the Baron and Kenny (1986) approach to test the mediation effect. The result indicated that investment efficiency mediates the relationship between earnings persistence, managerial ownership, concentration ownership, and firm performance.

CHAPTER 1

INTRODUCTION

1.1 Chapter Overview

This chapter presents the primary components of the study. The background of the study is introduced, as well as the research problems; after which, the research questions and study objectives are presented. Following the arguments and presentations of the above, the significance of the study is presented. Finally, the definitions of key terms are introduced in ensuring the readers of the thesis would be able to appreciate the flow of the processes accordingly.

1.2 Background of Study

Jordan is a country that lacks natural resources; therefore, it depends primarily on the private sector to provide jobs for its citizens (Ibrahim & Hanefah, 2016). Accordingly, to attract investors, significant efforts have been made. For example, Amman Stock Exchange (ASE) have been formed to help Jordanian regulatory environment by promoting transparency, disclosure, accountability, and thus would be improving firm performances accordingly.

The Amman Securities Exchange (ASE) was founded in 1978 after it became clear how important stock markets had been to the economy. (ASE) is considered as one of the key pillars of the Jordanian economy. The number of listed firms in (ASE) reached 191 in 2019, with a trading value of Jordanian Dinnar (JD) 1.5 billion. As well as, according to the statistics issued

by the Amman Stock Exchange Jordanian investors own 51.9% of the market value of Jordanian firms in the Amman Stock Exchange, whereas 48.1 is owned by foreign investors. Moreover, family firms form more than 40% of the total firms listed on the ASE. (Bataineh et al., 2018). The market capitalization for all the listed firms formed 71% of the GDP in 2014 (Amman Stock Exchange Annual Report, 2016). However, since its creation, the ASE has seen some volatility rise in a number of different areas. For example, the ratio of market capitalization to Gross Domestic Product (GDP) has decreased from 93.5 in 2012 to 49.7 in 2019, and the value traded has also decreased from 1,978.8 JD billion in 2012 to 1,585.4 JD billion in 2019, as well as, the number of traded shares has decreased from 2,384.1 billion in 2012 to 1,247.2 billion in 2019. (ASE, 2020).

The firm ownership in Jordan and neighboring countries, like Saudi Arabia, Syria, and Egypt concentrated in the hand of a few shareholders, and family ownership is dominant (Omet, 2006). Therefore, the Jordanian case of listed firms constitutes an interesting set to study because, in contrast with the developed countries, the main agency conflict is not the typical one between managers and shareholders, but between controlling shareholders and minority shareholders. On the other hand, ASE can be characterized as an unregulated market in that listed firms are not subjected to stringent disclosure requirements imposed by the market. Therefore, agency conflicts and information asymmetry between controlling shareholders and minority shareholders contributed to the increased such phenomenon (Suwaidan & Al-omari, 2004).

The poor performance of Jordanian firms was motivated by several reasons; first agency conflicts between controlling and minority shareholders, low level of transparency

(Al Lawati, 2021), and limited liquidity due to a lack of foreign investment. Most firms in emerging countries including Jordan suffer from institutional problems such as a concentrated ownership structure, which causes agency conflicts and asymmetric information arising from the lack of compatible regulations and sufficient supervision (Batainah, 2021).

The conflicting interests of controlling and minority shareholders may cause controlling shareholders to abuse their position of power and take advantage of their influence to obtain personal gains, such as paying themselves high salaries (Alhadab et al., 2020). As well, controlling shareholders may use their voting power to push through resolutions that primarily serve their interests, potentially without the consent of minority shareholders. This includes the appointment of directors or key corporate decisions (Al Amosh and Khatib, 2022). This leads to limited transparency and access to information regarding the company's financials, operations, or decision-making processes.

Therefore, the presence of such market imperfections restricts the firms' access to external capital; This is due to the fact that the outside investors and specifically minority shareholders are not confident that their investments will not be expropriated by insiders or controlling shareholders who control the firm's assets or that they will realize their returns on investment (Alkurdi et al., 2021). Thus, agency conflicts between controlling and minority shareholders might have important implications on firm performance. On other hand, according to the statistics issued by Jordan central bank, foreign direct investment decreased from 1,382.2 JD billion in 2012 to 402.3 JD million in 2020 (Jordan Central Bank, 2020). This might be

explained by the Middle East's instability, which has weakened investor trust throughout the area, particularly in Jordan.

It is clear from the above situations that had led to the performance of Jordanian firms had been decreasing. Several studies indicated that information asymmetry and agency conflicts could be the main frictions that lead to poor firm performance (Jensen & Meckling, 1976; Fama & Jensen, 1983). Rubino et al. (2017) indicated that agency conflicts between controlling shareholders and minority shareholders and problems of managerial opportunism contributed towards the inability to maximize firm value. Previous study had shown that various factors could be considered the drivers for firm performance. For example, earnings quality is critical in the financial analysis process in which high-quality earnings could assist financial analysts and investors to make appropriate decisions (Carmo et al., 2016).

Similarly, Islam et al. (2020) indicated that earnings quality is an influential indicator of financial flexibility. It means that if a firm's earnings are reflectively linked to relevant and pertinent information, then the firm gains confidence and it becomes easier to generate external financing. The situation shall entail the firm to be holding lesser cash. This suggests that since higher-quality earnings are more 'reliable' and fair; all employee-led forecasting, strategy and evaluation will accurately represent the firm's present situation and hence, will be more real and durable (Dang et al., 2020).

In the same vein, high earnings quality is associated with lower information asymmetry and lower systematic risk, accordingly would lead to high earnings quality and the results can be highly accurate information about the cash flows of the firm, which reduces the amount of

information risk (Ben-Nasr & Al-Dakheel, 2014). Ahmed (2020) provided evidence from Middle Eastern countries particularly, Gulf Council Countries (GCC), where the ownership of firms is concentrated and found that earnings quality has a positive and significant relationship with firm performance. Likewise, Ramadan (2015) reported that high earnings quality lead to high firm performance in Jordanian firms, where earnings quality reduces agency cost and limits the likelihood of engaging in earnings management, which will reflect positively on Jordanian firm performance.

Although earnings quality is not limited to accruals definition, previous studies had concentrated on one or more accruals measurement only (Alsufy et al. 2020; Utami et al. 2019). The present study highlights time-series properties of earnings namely persistence, smoothness and predictability. Francis et al. (2006) outlined that these properties are desirable for earnings quality. Earnings persistence indicates to the ability of firms to maintain earnings from the present to the future (Fatma & Hidayat, 2019), while the absence of variability is referred to as smoothness. Earnings predictability indicates the degree to which current earnings may be used to forecast future earnings. Several studies found that earnings persistence, earnings smoothness, and earnings predictability are an important predictor for firm stakeholders, for investors to provide investment, and impacts stock prices so that recorded earnings is high quality (Dimitropoulos et al., 2019; Houcine, 2017).

Another factor that would have affected firm performance is corporate governance. As mentioned earlier, Jordan suffers from the second type of agency problem. Therefore, how to build a better relationship between controlling shareholders and minority shareholders in order

to enhance better firm performance is an objective of corporate governance (Zaitul et al., 2019). By definition, corporate governance is a set of guidelines, laws, and regulations that affect how a firm is operated and governed (Abdalkrim, 2019). Accordingly, corporate governance is a framework to build an environment of accountability, trust, and transparency (Detthamrong et al., 2017). In response to creating a protected environment for investors in Jordan, corporate governance regulations were issued in 2009 (Abu Qa'dan & Suwaidan, 2019). The primary purpose of the code is to enhance corporate governance practices that protect the interests of all stakeholders. Thus, reducing information asymmetry and agency conflicts between controlling shareholders and minority shareholders. Moreover, shareholders have recognized the significance of corporate governance in maximizing the stability of firm performance (Alkurdi et al., 2021).

The Jordanian corporate governance code consists of several chapters. The current study highlights ownership structure and board composition. Ownership structure plays a vital role in firm growth strategies because of its effects on the decisions of managers that relate to firm results (Dong et al., 2020). The agency theory suggests that ownership structure is a significant corporate governance mechanism capable of reducing agency problems caused by ownership and control separation (Jensen & Meckling, 1976; Doan et al., 2020). Furthermore, the firm's ownership structure is considered an important monitoring mechanism for stakeholders; therefore, it may have a monitoring role in curtailing opportunistic decisions (Alzoubi, 2016).

Alabdullah (2018) pointed out that the ownership structure (managerial ownership, concentration ownership) in Jordan is a critical mechanism that enhances the performance of

Jordanian firms. Abu Haija and Alrabba (2017) indicated that the ownership structure in Jordan is vital for the firm performance, thus, potential investors should consider this structure when investing. Since Jordan's economy is based on the private sector, state ownership is limited. On the one hand, Jordan offers a unique opportunity to explore the topic of ownership structure due to its special ownership structure, which is characterised primarily by significant concentrations of ownership (Ibrahim & Hanefah, 2016). This clarifies why ownership structure is the predominant mechanism of control in Jordan (Alzoubi, 2016).

On the other hand, board composition is considered a key factor underlying corporate governance mechanisms. Moreover, the board has a significant role in implementing effective corporate governance practices (Al Fadli et al., 2020). The board supervises the activities of the firm and has duties such as setting policy, recommending, updating, assessing management strategies, and naming a chief executive officer (Shanikat & Abbadi, 2011). Accordingly, the current study will focus on the role of board composition and ownership structure in enhancing and firm performance. Previous studies found that board diversity such as board independence is critical factors that may improve firm performance (Nawaz, 2017). Musallam (2020) articulated a positive relationship between board independence and firm performance.

The current study also introduces investment efficiency as a mediator variable. Examining investment efficiency as a mediator factor plays a crucial role in uncovering the causality and orientation of the connections involving earnings quality, corporate governance, investment efficiency, and firm performance, as indicated by prior studies (Saleh et al., 2020; Aktan et al., 2018). This analysis can provide insights into whether earnings quality and corporate

governance have a leading role in influencing changes in investment efficiency, subsequently impacting firm performance, or if the associations function differently. Investment efficiency can serve as a mechanism for resolving conflicts between dominant and minority shareholders. When controlling shareholders exhibit a commitment to transparent and equitable investment procedures, it fosters trust among minority shareholders. This, in turn, aligns their interests toward enhancing firm performance by means of more sound decision-making, ultimately benefiting the entire company (Fauziah et al., 2021).

Investment efficiency means engaging in projects with net worth that are currently positive; and inefficiency means choosing projects with current negative net value (over investment), or not considering opportunities while investing (Hayati & Sedaghat, 2016). Investment efficiency can be affected by earnings quality. Alkhafaje et al. (2020) provided evidence from the Jordanian environment and found that earnings quality affect positively investment efficiency by mitigating both over-investment and under-investment. As well as, Bhatt & Bhatt, (2017) indicated that corporate governance enhances investment efficiency by decreasing agency conflicts between controlling shareholders and minority shareholders.

Furthermore, the efficiency of corporate investment is considered one of the most basic and important factors which decide the valuation of the firm, and thus the wealth of investors (Elberry, 2018). Likewise, Cao et al. (2020) indicates that a firm's investment efficiency determines its future cash flows and profitability and has a significant influence on the firm's growth and long-term survival (Cao & Rees, 2018). Prior studies have revealed that investment efficiency is related to firm performance. Titman et al. (2003) indicated that a manager's tendency

to over-investment affects negatively the firm's performance. In the same way, Cai and Zhang (2011) document that over-investment is associated with poor firm performance. Highly efficient investment in the firm's assets contribute to higher investment efficiency, thus increasing greater firm performance (Azhar et al., 2019).

Based on the previous discussions, this study will highlight the importance of earnings quality, and corporate governance in the Jordanian environment, by looking at their relationships with investment efficiency and firm performance.

1.3 Problem Statement

According to Jaafar and El-Shawa (2009), 51% of the Amman Stock Exchange shares are concentrated in the hands of a few shareholders who own more than 5% of the shares. This reflects a high level of ownership concentration among Jordanian firms. This is more prevalent in the industrial sector and the service sector, compared to the banking sector, which is more regulated (Alhadab et al., 2019). In such a setting, the principals- agent agency conflict (i.e. Type I agency problem) is less likely to be severe compared to the minority-majority shareholders' agency conflict (i.e. Type II agency problem) (Abu Qa'dan & Suwaidan 2019).

The second type of agency problem presumes severe agency costs between minority and controlling shareholders due to controlling shareholders trying to co-manage the firm because of their significant shareholding (Al Lawati et al., 2021). This is likely to necessitate further monitoring costs to mitigate agency conflicts (Fama & Jensen 1983). These costs can influence stock market valuation in countries with poor investor protection (Porta et al. 2002). Haddad et

al. (2015) indicated that Jordan which has a concentrated ownership structure suffers from the second type of agency problem that arises between controlling and non-controlling shareholders (i.e. minority shareholders).

There are several appearances of conflicts between controlling shareholders and minority shareholders. As such, there is a higher likelihood that family members hold executive and non-executive positions in such companies, potentially leading to a greater prevalence of agency conflict than in largely owned firms (Ananzeh et al., 2023). Also, across these companies, CEOs are likely to hold the role of board chairman (CEO duality) and, if this is not the case, then the CEO is likely to have a close interaction with the board chairman. In this regard, minority shareholders may have limited or no representation on the board of directors, leaving them without a direct voice in decision-making (Agyemang et al., 2015). In the same vein, majority shareholders who also hold executive positions in the company may set their own compensation at excessive levels, reducing the profits available for distribution to shareholders, including minorities. A company with concentrated ownership may also suffer from impaired independence because dominant shareholders may exert direct influence over the appointment and independence of auditors. Also, Guizani and Abdalkrim (2022) presented evidence from the Saudi environment, which is very similar to the Jordanian environment. Family-owned firms, dominant shareholders are reluctant to appoint independent directors and generally prefer to establish boards that do not try to alleviate their discretion over decision-making. This leads to a system in which the rights of minority shareholders are often neglected (Wahba, 2013).

Also, the large shareholders would find themselves in the position of having too much power that they can exploit to illegally benefit at the expense of small shareholders, especially if the latter group were not sufficiently protected by law or other means. Indeed, several studies in Jordan have documented that minority shareholders in Jordan do not receive sufficient protection (Alhadab et al., 2019; Haddad et al., 2015; Abdullatif et al., 2020). In this sense, Jordan particularly appears to represent an agency context since the ownership structure in the country is concentrated in the hands of few investors (Ananzeh et al., 2022).

According to these conflicts, there is an information asymmetry between controlling shareholders and minority shareholders in Jordanian firms. Iskandrani (2016) reported that information asymmetry between controlling shareholders and minority shareholders is a key determinant of market liquidity in Jordanian listed firms. In concentrated ownership settings such as Jordan, information asymmetry can happen when controlling shareholders have more or an advantage of information than minority shareholders (Hwang et al. 2019). Accordingly, the information asymmetry will cause the mispricing of the stock price in the market, which in turn, it might cause the slow development of the firm. Moreover, information asymmetry will affect the confidence of investors in investing as it causes fear that the controlling shareholders will benefit at their expense (Hwang et al. 2019). With the higher the information asymmetry, the greater the adverse selection cost incurred, which will lead to poor firm performance (Jensen and Meckling 1976; Majluf & Myers 1984).

According to Alhababsah (2019); Al Lawati et al. (2021); Haddad et al. (2015) in concentrated ownership settings such as Jordan, information asymmetry and agency conflicts

between controlling shareholders and minority shareholders could be primary frictions that lead to suboptimal firm policies, resulting in poor firm performance, low growth, and lower returns. Statistics issued by the Amman Stock Exchange indicate that firm performances in Jordan have decreased significantly, based on financial indicators. The decrease in the market value of firms from 19 billion in 2012 to 14 billion in 2019; and the decrease in turnover rates of stocks from 33.9 in 2012, to 18.2 in 2019. Moreover, the decrease in the earnings per share from 0.13 in 2012 to 0.05 in 2020. As well as, the decrease in the Price- Earnings (PE) Ratio from 15.6 in 2012 to 11.4 in 2019 (ASE, 2020). These numbers sounded the alarm and led to the weak confidence of investors in both information and the performance of firms.

In response to this situation, it seems that there is an urgent need to assess the performance of Jordanian firms and identify factors that can reduce information asymmetry and agency conflicts between controlling shareholders and minority shareholders in a concentrated ownership environment to enhance firm performance. Furthermore, when it comes to issues of firm performance, there is a lack of evidence in Jordan. For this purpose, more study is needed to help improve Jordan's corporate sector by assessing firm performance and, in turn, the Jordanian economy as a whole.

According to previous researches, such as Ali et al., (2018); Hayati and Sedaghat, (2016); Tran, (2020), investment efficiency is linked to reducing information asymmetry, which leads to lower moral hazards and adverse selection frictions. These findings also imply that when investment efficiency is increased, agency risk is reduced. This indicates that firms with a high

investment efficiency will have fewer agency difficulties as a result of management's opportunistic behavior (Majeed et al., 2018).

Investment efficiency enables firms to increase the wealth of shareholders over the long term, as an investment in profitable projects leads to positive returns that promote the long-term growth of the firm (Hu & Holmes, 2019). Inefficient investment could lead to investing in non-profitable projects, thereby distorting firm performance (Carvalho & Kalatzis, 2018). Many studies indicate that over-investment leads to damage in value of a firm and stakeholders, thus firm performance is adversely affected by expropriating existing resources of firms and investing in projects which are unprofitable to empire building (Jensen & Meckling, 1976).

The majority of studies suggest that inefficient investment is caused by two types of friction: moral hazard and adverse selection (Biddle et al., 2009; Stein, 2003). Therefore, in order to overcome these frictions and make the investment of firms efficient, firms are supposed to produce more truthful information, and this information is provided by earnings quality (Zhong & Gao, 2017; Bzeouich et al., 2019), as well as having strong corporate governance (Chen et al., 2017). Thus, earning quality, corporate governance and investment efficiency, complement each other for better performance.

Alsufy et al. (2020) conducted a study on Jordanian industrial public shareholding firms listed on Amman Stock Exchange and reported that earnings quality has a positive effect on investors' protection, improves the investors' confidence, and this will improve the share price. In addition, Afifa et al. (2020) indicated high earnings quality increases the market value of Jordanian industrial public shareholding firms. Likewise, Saleh (2020) found that the

performance of Jordanian public shareholding firms is positively affected by earnings quality. In other other words, high earnings quality positively affects the Return on Assets (ROA), Return on Equity (ROE), and Earnings per Share (EPS) of Jordanian public shareholding firms. Likewise, Ma and Ma (2017) state that low earnings quality is identified by untrue profitability and biased financial information, thereby detrimental to all interested users of a financial statement, such as current stakeholders and potential investors. Poor earnings quality also leads to information risks to investors, therefore increasing the cost of capital (Francis et al., 2006).

In concentrated ownership settings, where majority shareholders may be incentivized to expropriate wealth from minority shareholders, corporate governance play a twofold control role; they can prevent this expropriation not only from large shareholders but also from managers (Gisbert & Navallas 2013). Previous studies indicate that strong corporate governance enhances firm performance, primarily through acting as a monitoring platform to ensure balances and checks between controlling shareholders and minority shareholders, including that the interests of all stakeholders are fairly served (Nor et al., 2017). Strong corporate governance is based on mechanisms; transparency; and the concepts of fairness, accountability, and responsibility in the firm's management. Thereby, corporate governance has a positive relationship with firm performance (Alabdullah, 2018). He and Kyaw (2018) indicated that good corporate governance reduces investment inefficiency by decreasing over-investment and under-investment; and as such, improves firm performance.

In summary, Zhong and Gao (2017) indicated that any factor which contributes to reducing information asymmetry and agency conflicts between majority and minority also

contributes to improving investment efficiency, and ultimately enhances firm performance. Mediation theory stated that Independent Variables (IV) causes Mediator (M) causes Dependent Variables (DV). According to this theory, the current study measures the relationship between earnings quality, and corporate governance as the IVs, and firm performance as the DV, and how it is improved through investment efficiency as the mediating variable (MV). The current study hypothesizes that earnings quality, and corporate governance enhance firm performance. Also, earnings quality, and corporate governance enhance investment efficiency. In addition, investment efficiency enhances firm performance by reducing the conflicts between controlling shareholders and minority shareholders. Finally, investment efficiency mediates the relationship between earnings quality, corporate governance, and firm performance.

Investigating investment efficiency as a mediating variable helps to determine the causality and direction of the relationships between earnings quality, corporate governance, investment efficiency, and firm performance (Ma and Jin, 2016; Alsayegh et al., 2023). It can shed light on whether earnings quality and corporate governance lead to changes in investment efficiency, which then affects firm performance, or if the relationships operate in a different manner. Investment efficiency can act as a mechanism for resolving conflicts between controlling and minority shareholders. When controlling shareholders demonstrate commitment to transparent and fair investment processes, it fosters trust among minority shareholders. This, in turn, aligns their interests in improving firm performance through better decision-making, ultimately benefiting the company as a whole (Fauziah et al., 2021).

In other meaning, earnings quality, through the provision of reliable financial information, and corporate governance, by fostering ethical conduct, transparency, and accountability contributes to mitigating conflicts between majority and minority shareholders (Latif et al., 2017; Bekheet et al., 2019). This, in turn, results in improved investment efficiency, ultimately leading to the enhancement of firm performance (Salehi et. al., 2022).

Due to an increase in the importance of earnings quality, and corporate governance to investment efficiency and firm performance; numerous studies had been conducted to test the connections between them (Liu & Tian, 2019; Dou et al., 2019; Zandi et al., 2020). However, there is a lack of studies that have concentrated on firm performance in the Middle East, particularly in Jordan. First, the current study may fill up the gap in previous studies, most of the previous studies of earnings quality concentrated on accruals proxies, therefore, the current study concentrates on time series proxies of earnings quality. Second, Bawaneh (2020) recommended further research to be conducted with reference to corporate governance and firm performance in the Jordanian context, because the results were mixed.

Third, Musallam (2020) indicated that there is a lack of previous research investigating the mediating effect on the relationship between corporate governance and firm performance. Therefore, the present study takes a step further by looking at the role of investment efficiency as a mediating factor that explains the linkage between earnings quality, corporate governance and firm performance to fill the gaps in previous studies. Therefore, the current study is one of few studies that looks at the role of investment efficiency as a mediator variable amongst all these variables.

1.4 Research Questions

This study seeks to examine the interplay of earnings quality, corporate governance, investment efficiency, and firm performance of Jordanian listed firms as follows:

- 1- Does earnings quality and corporate governance influence firm performance of Jordanian listed firms?
- 2- Does earnings quality and corporate governance influence investment efficiency of Jordanian listed firms?
- 3- Does investment efficiency influence firm performance of Jordanian listed firms?
- 4- Does investment efficiency mediate the relationship between earnings quality, corporate governance, and firm performance among Jordanian listed firms?

1.5 Research Objectives

The main objective of this study is to examine the interplay of earnings quality, corporate governance, investment efficiency, and firm performance of Jordanian firms listed in the stock exchange. The objectives of this study can be clarified as follows:

- 1- To examine the relationship between earnings quality, corporate governance and firm performance of Jordanian listed firms.

2- To examine the relationship between earnings quality, corporate governance and investment efficiency of Jordanian listed firms.

3- To examine the relationship between investment efficiency and firm performance of Jordanian listed firms.

4- To examine the mediation effect of investment efficiency between earnings quality, corporate governance, and firm performance among Jordanian listed firms.

1.6 Scope of Study

This study seeks to understand the extent of earnings quality, and corporate governance in the services and industry of the Jordanian economy. More importantly, on their relationship with firm performance, taking into account investment efficiency as a mediator variable as an empirical study in the Jordanian service and industry sectors. As a starting point, the Jordanian service and industry sectors are both vital economic sectors; this is due to their vast overall contribution to Gross Domestic Product (GDP). The Jordanian service and industry sectors have great impact on the development of their country's economy; and these sectors have witnessed many developments, placing them on equal footing with their counterparts in America and European countries (Alabdullah, 2018).

The current study highlights on service and industrial sectors because previous studies indicated that service and industrial sectors are more concentrated ownership than the financial sector (Shatnawi et al., 2021; Al-msiedeen et al., 2018). Therefore, agency conflicts and information asymmetry between controlling shareholders and minority shareholders in the

service and industrial sectors could be more than in the financial sector. The Jordanian economy is dominated by the services and industry sectors. The economic indicators as shown in Table (1.4) confirm this established fact; the services sector contributed more than 61% to GDP in 2018, and the industrial sector contributed 27%, while the agricultural sector contributed 5% (Statista, 2018). Furthermore, Labour resources engaged in services make up to around 72% of the labour force; with 24% of the Jordanian labor force working in the industry sector, while only 3% come under the agricultural sector (Statista, 2019).

Table 1.1 Gross Domestic Product and Labour Force by Sectors

Sector	GPD	Labour Force
Services Sector	61%	72%
Industry Sector	27%	24%
Agricultural Sector	5%	3%

The service and industry sectors are associated with various economic sectors as they provide numerous services and goods to the economy, thereby ensuring that any factor affecting these sectors, will affect all sectors. There were a total of 44 operating institutions that had been registered on the Amman Stock Exchange in Jordan under the service sector at the end of the year 2019. These institutions were listed under the Jordanian service sector where they had been classified by the nature of their activity (Business) according to eight sub-sectors. These were Media; Commercial Services; Transportation; Health Care Services; Technology and Communication; Utilities Educational Services; Energy; and Hotels and Tourism. As at the end

of 2019, there were also 39 operating institutions listed on the Amman Stock Exchange under the industry sector, which were also classified under eight sub-sectors of Leather and Textile, Electrical, Engineering and Construction, Extractive and Mining, Tobacco and Cigarettes, Food and Drinks, Chemical, Pharmaceutical and Medical (ASE, 2019). Accordingly, the final list of the sample was 83 firms.

1.7 Significance of the Study

This study's significance can be assessed from two viewpoints: theoretical and practical. These are elucidated below.

1.7.1 Theoretical Significance

The research study attempts to provide practical and theoretical contributions to the field of firm performance and earnings quality, and corporate governance from the agency theory perspective in Jordan. Regarding the theoretical contributions, the current study seeks to shed light on the role of earnings quality, and corporate governance on firm performance. Findings from the current study offer a deeper understanding of how earnings quality and corporate governance influence firm performance by employing investment efficiency (as the mediating variable) to investigate indirect relations between earnings quality, corporate governance, and firm performance.

Most of the previous studies highlight the first type of the agency theory. However, the main agency problem in Jordan is the second type of agency between controlling shareholders and minority shareholders. Therefore, the current study will employ agency theory to explain the

linkage between these variables. The current study seeks to fill the gap in the literature by investigating the fit between earnings quality, corporate governance, and investment efficiency within the context of firm performance. Moreover, the study seeks to shed some light on the role of investment efficiency towards firm performance.

1.7.2 Practical Significance

In practical terms, the findings of this study may assist finance managers, CEOs, and decision-makers in enhancing firm performance through earnings quality and corporate governance. Moreover, the results of the current study will provide an integrated model that can achieve better performance for industrial and service sectors by applying corporate governance and earnings quality through investment efficiency. Thus, firms can achieve better performance than before. Furthermore, due to the limited empirical research on earnings quality, corporate governance, and investment efficiency in the Jordanian industrial and services sector, the findings of this study could motivate further research in this area and provide a wider avenue for future research.

1.8 Definitions of Key Terms

The key terms are presented as follows:

(A) Earnings Quality

Earnings quality can be defined from various perspectives. The present study indicates earnings quality through three aspects: persistence, smoothness and predictability. Therefore, earnings quality can be defined as the ability of firms to retain earnings over time rather than just attributing it to a given event; in other words, the ability of firms to maintain earnings from the present to the future (Fatma & Hidayat, 2019), as well as, also referring to ‘the relative absence of variability’. Finally, earnings quality indicates the degree to which the current earnings may be used to forecast future earnings (Francis et al., 2006).

(B) Corporate Governance

Corporate governance is defined as a series of procedures and processes to direct and control a firm. It is a series of guidelines that govern the relations between shareholders, stakeholders and management (Ching et al, 2006).

(C) Investment Efficiency

The present study employs investment sensitivity measurement to be a proxy for investment efficiency. Investment efficiency means engaging in projects with net worth currently being positive; and inefficiency means choosing projects with current negative net value (over-investment) and losing investment opportunities with positive net present value (under-investment) (Hayati & Sedaghat, 2016).

(D) Firm Performance

Firm performance in the current study refers to Tobin's Q measure which is based on accounting and market figures. Tobin's Q is the market value of a firm's assets (measured by share price multiplied by the total number of shares plus debt at book value) to their replacement cost (measured by the total of assets at book value) (Tobin, 1969).

1.9 Organization of the Thesis

The current thesis is organized into six chapters. Chapter 1 provides the background, problem statement research questions, research objectives, the significance of the study, definitions of key terms, and the organization of the remaining chapters. Chapter 2 shows the background and a review of the literature and previous research. Chapter 3 contains the theory that has been applied, the theoretical framework and hypotheses development of the study, and the summary of the chapter. Chapter 4 shows an overview, research design, unit of analysis population and sample, sources of data, measurement of variables, statistical techniques, and summary of the chapter. Chapter 5 shows the analysis of the findings of the study. Lastly, Chapter 6 summarizes the main findings of the current study and discusses the interpretation of the results. The implications of the findings are also discussed, together with limitations and suggestions for future research.

CHAPTER 2

LITERATURE REVIEW

2.1 Chapter Overview

The purpose of current study is to examine the relationships between earnings quality, corporate governance, investment efficiency, and firm performance. This chapter outlines and reviews related literature of the phenomenon in question, and the relevant theoretical foundation.

2.2 Firm Performance

The performance of firms has always been of interest to management teams and researchers. Although it is a well-known concept in academic literature, there is no agreement on how it is defined and measured (Taouab & Issor, 2019). Santos & Brito (2012) defined ‘firm performance as a subset of organisational effectiveness that covers operational and financial outcomes.

Daft (2010) interprets firm performance as the ability of a firm to be efficient and effective in the utilisation of resources to accomplish its goals. The author refers to efficiency as ‘the amount of resources used to achieve the organisation’s goals. Meanwhile, effectiveness is a broader term, meaning the degree to which an organisation achieves its goals’. As many know, firms utilise all their energy whether financial or non- financial, to enhance performance. Therefore, the current study can interpret performance as the outcome obtained through the utilisation of the firm's energy.

To achieve its objectives, the best way for the firm to be effective is to have clearly defined objectives and to be adequately strategic in its business strategy (Melhem, 2016). One such strategy is to use accurate information to mitigate information asymmetry between controlling shareholders and minority shareholders. The existence of information asymmetry between them may lead to firms engaging in projects with negative present value, and thus, a decline in firm performance.

Amman Stock Exchange issued several numbers regarding the performance of listed firms such as the ratio of market capitalization to Gross Domestic Product (GDP) has decreased from 289.1 in 2007 to 56.1 in 2022, and the value traded has also decreased from 12,348.1 JD billion in 2007 to 1,903.7 JD billion in 2022, as well as, the number of traded shares has decreased from 4,479,369,609 in 2007 to 1,155,652,113 in 2022. Moreover, the number of listed firms decreased from 245 firms in 2007 to 170 firms in 2022. The volume of non-Jordanians purchasing shares on the Amman Stock Exchange decreased from 2825.3 billion to 274.2 million. Given the statistics issued by ASE, it can be noted that the performance of Jordanian firms is severely decreasing (Dakhlallh et al., 2020). Therefore, investigating which factors that may enhance the performance of Jordanian firms could be a main contribution of the current study.

Jordan firms suffer from institutional problems such as a concentrated ownership structure, low level of transparency, and weak investor protection, all of which cause agency problems and information asymmetry arising from the lack of compatible regulations and sufficient supervision (Sharabati, 2018). The Jordanian case of listed firms constitutes an interesting set to study because the main agency conflict is between the controlling shareholders

and minority shareholders. In this case, the firm's capacity to access external finance will be hampered (Alkurdi et al., 2021).

High concentrated ownership in Jordanian firms leads to encroaching on the rights of minority shareholders. Such as in Jordanian concentrated firms often the CEO is the same as the chairman of the board of directors. As a result, there is a lack of separation of powers when one person fills both positions, which could result in a lack of independent scrutiny. This can make dealing with problems involving poor performance or unethical behavior more difficult (Kanakriyah, 2021). Additionally, board members of Jordanian concentrated firms are typically the controlling shareholders' friends or relatives. As a result, it may be less probable for board members who are close friends or family of the dominant shareholders to exercise independent monitoring and question management choices (Alhadab et al., 2019). The board's capacity to act in each shareholder's best interest may be compromised by this. Furthermore, the controlling shareholders have the authority to pay their relatives large wages and promote their family members to senior positions inside the company, which is detrimental to minority shareholders' interests (Ananzeh, 2022).

In this setting, controlling shareholders seek to expropriate the wealth of minority shareholders by obtaining incentives and benefits of their own. Also, the divergence of interests between controlling and minority shareholders may lead controlling shareholders in Jordanian firms to assign inefficient family members to top managerial and board positions (Ananzeh et al., 2022). According to Alhababsah (2019); Al Lawati et al. (2021); Haddad et al. (2015) in concentrated ownership settings such as Jordan, information asymmetry and agency conflicts