

Corporate Governance Mechanisms and Firms' Financial Performance: The Moderating Role of CEO Compensation in Jordan

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Abstract

The objective of the study is to examine the relationship between audit committee characteristics (AC size, AC activity, AC independence, AC expertise) on Firm Financial Performance Furthermore, the study also identifies the influence of CEO compensation as a moderating variable on this relationship. It will contribute to the field's literature through providing new evidence on the association between AC with firms' performance and Filling an international gap in previous literatures by selecting CEO Compensation as the moderator variable on the relationship between audit committee characteristics and Firm Financial Performance. Previous studies had never selected such a variable. This option has not been investigated in either developed or developing countries, including Jordan. This study's contribution will enrich and expand the international literature on Corporate Governance Mechanisms and firm performance The sample of the study consists of all the non-financial Jordanian public listed companies on the Amman Stock Exchange (ASE) for the years 2017-2023. Finally, this study will help managers and policymakers improve their efficiency and protect their firms from failure in such an environment with limited access to external funding and a strong impact of firm performance on overall economic growth and welfare. Regulatory bodies like the Amman Stock Exchange (ASE) financial institution management, as well as academic researchers, are expected to use this study as a guide The data is analyzed using STATA Statistical Software (Version 14.2) after filling the theoretical gap on how audit committee characteristics have unique characteristics that undermine the presence and exposure of Firm Financial Performance sustainability

Keywords: Firm Financial Performance, Agency Theory, Corporate Governance, Ceo Compensation, Audit Committee Characteristics

Introduction

Due to its beneficial effects on strengthening the economy, resolving social issues, and eradicating unemployment, firm performance has become an increasingly essential topic for scholars and researchers (Palacios-Marqués, Peris-Ortiz, & Merigó, 2013); (Cooke, 2001a). It has been looked into in the accounting and management literature using

agency theory as a significant dependent variable that should be improved as a key objective (Bauer, Frijns, Otten, & Tourani-Rad, 2008)

Performance is a function of an organization's capacity to acquire and manage resources in a variety of ways to create a competitive advantage. (Alamro & Al-soub, 2012). Moreover, one of the most crucial aspects that investors evaluate when making decisions is the firm's performance, which is seen as a source of economies' sustained growth. Other stakeholders, like managers, creditors, employees, and the government, value corporate performance as well. However, there isn't agreement on how to assess and gauge a company's financial performance. (Tsai & Mutuc, 2020)(Richard, Devinney, Yip, & Johnson, 2009;Vieira, Neves, & Dias, 2019). The importance of performance measurement in converting an organization's strategy into desired actions and outcomes has been examined (Vij & Bedi, 2016). Analysis of a company's financial performance can be done in terms of profitability, sales turnover, asset growth, dividend growth, and capital employed, among other things. (Siew Tee & Nizam, 2020) company's performance is based on the assets and skills it possesses as a source of long-term competitive advantages in the market (Rosli, 2020).

Improvements in market share, profitability, sales growth, return on investment, and overall performance are used to characterize firm performance. (Zehir, Altindag, & Acar, 2011) Although business performance does improve In a positive feedback loop of recognition and the generation of economic value, reputation becomes a competitive advantage and an asset that enables businesses to invest in, expand, and raise their financial performance. (Orozco et al., 2018). Moreover, one of the indicators of an organization's success and efficiency in attaining its goals is financial performance. When the management can choose appropriate objectives or the right tools to accomplish them, it is effective. In contrast, efficiency refers to the ratio of input to output that, given a given income, results in the best possible outcome. (Karamoy & Tulung, 2020b). The company's performance, which reflects the function of each employee working there and carrying out a specific task assigned to him, is used to gauge how effective the organization's senior management team is. Therefore, performance is a gauge of how successfully and efficiently an organization is run and how its human and other resources are used.(Matar & Eneizan, 2018).

From the years 1999–2009 Jordan experienced impressive growth acceleration, tripling its exports and increasing income per capita by 38 percent. Since then, a number of external shocks that include the Global Financial Crisis (2008-2009), the Arab Spring (2011), the Syrian Civil War (2011), and the emergence of the Islamic State (2014) have affected Jordan in significant ways and thrown its economy out of balance (Ahmad & Ganesan, n.d.). Jordan's debt-to-GDP ratio has ballooned from 55percent (2009) to 94 percent Now Jordan is experiencing poor financial performance in both the industrial and service sectors (Alabdullah, 2018) Moreover, Jordanian non-financial firms have faced several problems and decrease starting from 2011. They showed that Jordan economy, especially non-financial firms, have faced several problems and challenges because of the regional instability, high level of unemployment, a dependency on remittances, and grants from Gulf economies besides continued pressure on natural resources (Alabdullah, 2018 ,Ahmad & Ganesan, n.d.)

There is a growing interest in researching the effect of corporate governance on firm performance as a result of widespread accounting scandals and corporate governance

failures in recent years. (Zhou et al., 2018). Many studies indicated that corporate governance has a substantial role to enhance firm performance (AL Nasser, 2019, Goel, 2018, Iqbal, Nawaz, & Ehsan, 2019, Saidat, Silva, & Seaman, 2019). However, due to its significant impact on the corporation, corporate governance is a major topic of academic inquiry. (Paniagua et al., 2018) and Corporate governance is essential for developing an organization's culture of mindfulness, openness, and transparency (Al-ahdal et al., 2020). The Combined Code in the United Kingdom, the Organization for Economic Development (OECD) Code, the Sarbanes-Oxley Act in the USA, and the Jordanian Corporate Governance Code (JCGC) are just a few examples of the many amendments and standards that have brought attention to the importance of studying corporate governance (Saleem & Alzoubi, 2016).

In the Jordanian context, CG practices still insufficient and underdeveloped. The flaws in the institutional and policy environments contribute to business managers' wrongdoing. It may be concluded that effectiveness of the corporate governance rules have an important role in Jordanian firms' financial health (Irshoud, 2022). Therefore, importance of investigating CG mechanisms cannot be neglected, since the weak structures of CG lead to great failure of the overall structure, which further highlighted the urgent need for investigation that aims ultimately to involve in the enhance CG. Furthermore, various environmental and contextual elements affect firm behaviour. Firms' CG is determined by the frameworks in the country where they operate. CG structures and their implications for corporate performance differ significantly between the developed and developing economies. According to the literature, CG in emerging or developing countries is restricted and complex (Kijkasiwat et al., 2022).

Additionally, from a different angle The highest executive position in a company is held by a Chief Executive Officer (CEO). The CEO is crucial in defining and executing a company's mission and vision as well as its short- and long-term goals, allocating resources and making investment decisions. (Setiawan, Kee, et al., 2017, A. M. H. Aldegis & Ganesan, n.d.) Furthermore, the study aims to contribute to a growing literature by examining the moderating role of CEO compensation among the variables that mentioned above.

Literature Review

Firm Financial Performance

Performance measurement involves capturing the intricate aspects of performance and representing those using organized symbols that can be comprehended and communicated consistently across similar situations (Lebas, 1995) One of the indicators of the effectiveness as well as efficiency of an organization to achieve its objectives is financial performance. When the management is able to choose suitable objectives or adequate tools to attain them, it is effective. Furthermore, efficiency is the ratio of input to output in a given situation where income results in the best possible outcomes (Karamoy & Tulung, 2020a) The separation of management and ownership, according to agency theory, leads to increased agency conflicts and costs, as well as information asymmetry, which enhances managers' self-serving behavior (A. M. Aldegis et al., 2023) Firm performance is compared to an engine in terms of determining its social, economic, as well as political progress. Every company should run under performance-based circumstances in order to survive in a business environment (Palacios-Marqués et al., 2013, Cooke, 2001b; Taouab & Issor, 2019) Drawing on agency theory, firm performance has been studied in accounting and management literature

as a significant dependent variable that should be improved as a key objective (Bauer et al., 2008b)

Audit Committee Characteristics

Audit Committee Characteristics CG structures identify the distribution of rights and obligations among a society's numerous stakeholders, such as board of directors, audit committees, shareholders, managers, and others, as well as the rules and procedures for making various decisions. In this regard, the role of AC in implementing CG codes and increasing business value is critical. Audit committees should be independent, active and carry out their obligations with professionalism, according to CG norms. In cases of financial manipulation, the AC is held accountable, which is why AC transparency reduces knowledge asymmetry and increases firm performance (Sadaa et al., 2023 Shamsuddin & Alshahri, 2022). In the last few years, many capital market authorities and academics have become aware of audit committees and external auditors. The principal purpose of these two committees is to supervise financial reporting procedures in order to ensure accurate reporting of firm performance (Almaqtari et al., 2021). Although the sharing of material information affecting the business's performance is consistent with the principle of utmost good faith, this is not always true (Safari Gerayli et al., 2021). CG has brought drastic changes in the area of business and particularly, in the fields of accounting and auditing. Audit committees as instruments for corporate governance has drawn more attention and interest in recent years (Buallay, 2018). The board has given the AC a number of crucial tasks, including the oversight of corporate governance and financial reporting, making it a significant mechanism for corporate governance (Ashari & Krismiaji, 2020). Audit committees in companies are, in fact, the subgroup of the board of directors. It is a significant mechanism of CG that aims at boosting the reliability and integrity of firm's financial information and raising public trust in the financial statements (Tornyeva, 2012). Depending on the objectives and duties, audit committees are defined variously. The main responsibility of AC is to supervise the internal accounting controls, the audit process, financial reporting procedures, and, finally, risk management procedures in a firm (Klein, 2005). According to agency theory, disputes and disagreements between managers and shareholders frequently stem from the former prioritizing their own interests over those of the shareholders. The hypothesis also links this issue to bad managerial ethics, etiquette, and behaviour (Rochmah Ika & Mohd Ghazali, 2012). In this situation, weak corporate governance standards, a lack of effective control and monitoring techniques, and a failure to implement market and operational regulations provide an ideal atmosphere for managerial malfeasance (Al-ahdal & Hashim, 2022). Mohammed and Hamdan (2013) indicate that the committee is made up of non-executive directors. An AC is a group of people chosen from the board of directors who are in charge of maintaining the independence of the auditor. Its main purpose is to improve the quality of auditing and question the board of directors. To ensure the validity of financial statements in a firm, an audit committee is in charge of assuring that these statements comply with accounting principles that were accepted (Lin & Hwang, 2010). Furthermore, an audit committee serves as a liaison between external and internal auditors and is in charge of overseeing the accounting procedure (Piot & Janin, 2007). According to agency theory, the creation of an AC can help to decrease information asymmetry, managerial opportunism, as well as enhance disclosure quality (Agyei-mensah, 2019)

Audit Committee Size

According to agency theory, the size of the audit committee is supposed to increase profitability because its primary role is to support the Board of Directors' oversight in an effort to improve financial disclosure (Musah et al., 2025; Oroud, 2019) Following the main financial failures and crisis, effectiveness of the AC was given broad jurisdiction to ensure the accuracy of financial reports (Wilbanks et al., 2017). A significant corpus of research and academic inquiry is now focusing on ACs' ability to accomplish their obligations, as well as the impact of successful ACs on company financial performance. ACs are an important part of the monitoring system, helping to decrease information asymmetry, promote openness and accountability, and boost trust in firm financial reporting and governance processes (Mallin, 2016; Kao & Chen, 2020). AC size considered one of the most important characteristics of the AC. Several prior studies examined the association of AC size with firm's performance, but with inconsistent results

Numerous studies have looked at the size as an AC component in audit committees. The criteria for measuring audit committees is the number of individuals working as members there. According to Jordanian Corporate Governance Code in 2017, a firm need possessing at least three members in the AC. According to Vafeas (2005), increasing the number of audit committees may improve their efficiency. Zájbojníková (2016) indicates that AC size has a significantly positive impact on firm performance. Qaiser Rafique and Al Mamun (2015) found that AC size has a positive effect on firm's performance. Issaa and Siam (2020) found that AC size has a significantly positive influence on firm performance. Rahman et al. (2019) showed that there is a significantly positive association between AC size and firm performance. Orjinta and Evelyn (2018) found that AC size has a significantly positive effect on firm performance. Altin (2024) indicates that AC size possess a significantly positive influence on firm performance

Al-Matari et al. (2014) found that AC size has insignificant influence on firm performance. Al-ahdal and Hashim (2022) revealed that AC size possess insignificant effect on firms' performance. Qeshta et al. (2021) indicates that AC size has insignificant influence on firm's performance. Al-Zaimoor et al. (2024) revealed that AC size has insignificant influence on firms' performance. While Fariha et al. (2022) found that AC size has a significantly negative influence on Tobins' Q. Al-Jalahma (2022) indicates that AC size is associated with poor performance

Audit Committee Activity

Agency theory emphasizes the conflict of interest between management and shareholders, necessitating governance mechanisms to mitigate agency costs. Audit committee meetings serve as a governance tool, providing a platform for monitoring internal controls, evaluating financial reports, and reducing agency risks (Musah et al., 2025) The significance of an AC is increasingly recognized in the literature, but little research has been conducted on board committees in developing economies (Qaiser Rafique & Al Mamun, 2015). This study expand on previous research on the significance of AC characteristics (size, independence, activity, and expertise) by examining several previously unexplored, but critical, attributes represented in audit committees. The current study also test how these characteristics play a role in affecting firms' performance in the developing economy context (Jordan). In this regards, how frequently members gather to address various challenges facing

a corporation is a crucial indicator of the effective role of an audit committee (Katmon & Farooque, 2017). JCGC in 2017 stipulates that audit committee meetings must occur at least three times annually. Audit committees should set up the necessary time for regular meetings in order to adequately oversee corporate reporting along with other duties (Buallay, 2018). As a result, the frequency of meetings is regarded as a key attribute of audit committees. Regular board meetings increase the possibility that members will carry out their duties with caution. This suggests that audit committees should set aside enough time to discuss topics related to a firm's financial operations and auditing. Meeting frequently suggests an active audit committee that addresses any immediate problems and provides greater monitoring, leading to enhanced financial reporting quality that may help detect profits management (Katmon & Farooque, 2017). Zájbojníková (2016) revealed that AC meetings have a significantly positive influence on firm performance. Issaa and Siam (2020) indicate that AC meetings has a significantly positive influence on firm performance. Orjinta and Evelyn (2018) found that AC meetings have a significantly positive impact on firm performance. While Rahman et al. (2019) showed that AC meetings have a significantly negative impact on firm performance. Qeshta et al. (2021) indicate that AC meetings have significantly negative influence on firm's performance. Al- Matari et al. (2014) found that AC meeting has an insignificant impact on firm performance. Fariha et al. (2022) indicates that AC meetings has insignificant influence on firms' performance. Altin (2024) indicates that AC meetings possess an insignificant influence on firm performance. Al-Zaimoor et al. (2024) revealed that AC meetings has insignificant influence on firms' performance. Al-Jalahma (2022) revealed that AC meetings has insignificant impact on firms' performance. Al-ahdal and Hashim (2022) showed that AC meetings have insignificant effect on firms' performance

Audit Committee Independence

According to the agency theory, the independence of the Audit Committee plays a key role in ensuring the control of financial reports that leads to improved performance of the company (Oroud, 2019)

Independent directors on audit committees with a high level of integrity can match words with action to enhance firm performance while also allowing them to perform their oversight functions effectively and ensuring that audit committee members meet on a regular basis to address important issues that may impede organizational performance, particularly during the economic recession (Orjinta & Evelyn, 2018). Prior studies have reported mixed results

Independent directors are those who do not have relationships with firm managers or owners (Pérez-Cornejo et al., 2019). A group that is completely made up of independent directors is an independent audit committee (Goodwin-stewart & Kent, 2006). The effectiveness of the board's functions, such as the standard of auditing, independence in the nomination process, and consideration of compensation, is typically increased by AC independence (ACI). The success of the board is directly related to the audit committee's duties, which include examining financial reporting and monitoring executive activity. When an AC operates independently, it can effectively supervise executive conduct on behalf of the board. This suggests that AC's independence enhances the board's monitoring role, and then, improves firm performance and increases shareholder wealth (Farooque, 2019; Tornyeva, 2012)

Kallamu and Saat (2015) showed that AC independence has a positive impact on firms' performance. Qaiser Rafique and Al Mamun (2015) found that AC independence has a positive effect on firm's performance. Issaa and Siam (2020) found that AC independence has a significantly positive influence on firm performance. Orjinta and Evelyn (2018) found that AC independence has a significantly positive impact on firm performance. Altin (2024) indicates that AC independence possess a significantly positive influence on firm performance. Al-Zaimoor et al. (2024) revealed that AC independence has a significantly positive influence on firms' performance

In contrast, Al-Jalahma (2022) revealed that AC independence is related with poor performance. Zájbojníková (2016) indicates that AC independence has a significantly negative effect on firm performance. Gurusamy (2017) showed that AC independence is negatively associated with firms' performance. While Al-Matari et al. (2014) indicate that AC independence has an insignificant impact on firm performance. Al-ahdal and Hashim (2022) showed that AC independence has insignificant effect on firms' performance. Safari Gerayli et al. (2021) found that AC independence has insignificant impact on firm's FRQ. Qeshta et al. (2021) indicate that AC independence has insignificant influence on firm's performance

Audit Committee Expertise

According to agency theory, members who have a background in finance are better able to assist the audit committee to assess the judgments of auditors and can help create more rigorous internal control systems as well as risk-management frameworks (Buallay, 2018)

The financial and accounting expertise of the AC is important characteristic for enhancing the quality of companies reporting, detecting frauds cases and errors, and conveying appropriate information to the related parties, as reported by several studies (Mohd Saleh et al., 2007; Iyer et al., 2012; Issaa & Siam, 2020; Altin, 2024). Companies are required by section 407 of the Sarbanes-Oxley Act (SOX) to state if the committee includes a financial expert. It is necessary that companies declare it and the cause of any financial expertise vacancies if any exist. In the first draft of the proposal, the only direct accounting and auditing knowledge that audit committee members had was categorized by SOX as financial expertise (Lee et al., 2019)

The most notable aspect of audit committee effectiveness that has recently attracted regulators' attention is their financial knowledge (Bilal et al., 2018). The last revised code on corporate governance in Jordan, in 2017, required all members of audit committees to have a financial background and at least one of the members to have recent and relevant financial and accounting experience or be a member of a professional accounting association. Audit committee members who are financial experts have an important role as they can support auditors. Katmon and Farooque (2017) defined audit committee expertise as having AC's members with expertise on the committee, as opposed to others (Goodwin-stewart & Kent, 2006). Financially knowledgeable committee members are more qualified in terms of understanding the financial transactions and reporting concerns of firms, persuading amateur audit committee members in accounting decisions, and guiding auditors from dismissal because of disagreements with management (Alderman & Jollineau, 2020)

The audit committees with financial expertise improves the quality of the prepared financial reports (Farhan et al., 2017). Meanwhile, no effect has been found for the number of the financial experts on firm performance. Alqatamin (2018) revealed insignificant of AC expertise association with firm performance. On the contrary, (Ashari & Krismiaji, 2020) showed that the audit committee expertise positively affects firm performance

Zábojníková (2016) revealed that AC experience has a significantly positive influence on firm performance. Safari Gerayli et al. (2021) indicates that AC expertise has significant positive impact on firm's FRQ. Qaiser Rafique and Al Mamun (2015) found that AC expertise has a positive effect on firm's performance. Issaa and Siam (2020) indicates that AC expertise has a significantly positive influence on firm performance. Altin (2024) indicates that AC expertise possess a significantly positive influence on firm performance while Al-ahdal and Hashim (2022) showed that AC expertise has insignificant effect on firms' performance. Orjinta and Evelyn (2018) found that AC qualification has insignificant impact on performance of the firm. Qeshta et al. (2021) indicates that AC experience has insignificant influence on firm's performance. Al-Zaimoor et al. (2024) revealed that AC expertise has a significantly negative influence on firms' performance

CEO Compensation as the Moderator Variable

Even though Audit Committee Characteristics has been extensively studied in relation to Firm Financial Performance (Oroud, 2019 Lee & Park, 2019, Alqatamin, 2018a; Musah et al., 2025, Shamsuddin & Alshahri, 2022, Almaqtari et al., 2021, Safari Gerayli et al., 2021, Buallay, 2018, Ashari & Krismiaji, 2020, Tornyeva, 2012, Klein, 2005, Rochmah Ika & Mohd Ghazali, 2012, Al-ahdal & Hashim, 2022, Mohammed and Hamdan (2013) Piot & Janin, 2007, Agyei-mensah, 2019; Wilbanks et al., 2017, Mallin, 2016; Kao & Chen, 2020, Zábojníková 2016, Issaa and Siam 2020, Rahman et al. 2019, Orjinta and Evelyn 2018, Altin 2024, Al-Matari et al. 2014, Qeshta et al. 2021, Al-Zaimoor et al 2024, Al-Jalahma 2022, Katmon & Farooque, 2017, Fariha et al. 2022, Orjinta & Evelyn, 2018, Pérez-Cornejo et al., 2019, Goodwin-stewart & Kent, 2006 Farooque, 2019, Kallamu and Saat 2015, Gurusamy 2017, Mohd Saleh et al., 2007; Iyer et al., 2012; Bilal et al., 2018, Alderman & Jollineau, 2020, Farhan et al., 2017, Qaiser Rafique and Al Mamun 2015)) which the CG Mechanisms is as independent variable and firm performance as dependent one. However, no previous study investigated nor chose the role of CEO compensation as a moderator variable on the relationship CG Mechanisms with Firm Performance There are two primary reasons for the current study. The first relates to the rationale behind the current study's selection and handling of a moderator variable, and the second explains why CEO compensation is a suitable moderator variable on the relationship between CG Mechanisms with firm performance

The first justification for selecting a moderator variable is that, according to Baron and Kenny (1986), Frazier et al. (2004), and Holmbeck, (1997) when there is a weak or inconsistent relationship between an independent and dependent variable, the moderator variable can be established to strengthen or weaken that relationship and to explain when or for whom an independent variable affects a dependent one

The second reason CEO compensation is a good moderator variable is that addressing issues and disputes between executives and shareholders is one of the key goals of the corporate governance system the highest executive position in a company is held by a Chief

Executive Officer (CEO). According to (Setiawan, Phua, et al., 2017) the CEO is crucial in designing and carrying out a company's mission and vision, creating a plan to achieve both short- and long- term goals, and making decisions on resource allocation and investment. Corporate governance and CEO compensation both exist to resolve agency conflicts between shareholders and managers According to agency theory; CEOs should be incentivized to match their aims with those of their shareholders. As a result, if a CEO's compensation is connected to shareholder return, the CEOs will support the firm's performance, which benefits both shareholders and stakeholders. This is especially true for successful CEOs, as anything related to a company's performance can have a beneficial influence on the shareholder profitability. Based on this logic, high levels of CEO compensation can be as an indicator to CEO talent(Pucheta-Martínez & Gallego-Álvarez, 2021) and, thus, may have an effect on the firm's performance. CEO compensation plans are one potential solution to the agency problem, which is how to structure the contractual relationship between the owner and the manager to give sufficient incentives for the manager to make decisions that maximize the owner's wealth. Becht et al. (2003) argue that the form of executive compensation contracts can have a significant impact on aligning shareholders' and management's objectives; thus, good incentive design can reduce agency costs.(Jensen & Meckling, 1976) also noted that a suitable compensation plan could save agency expenditures

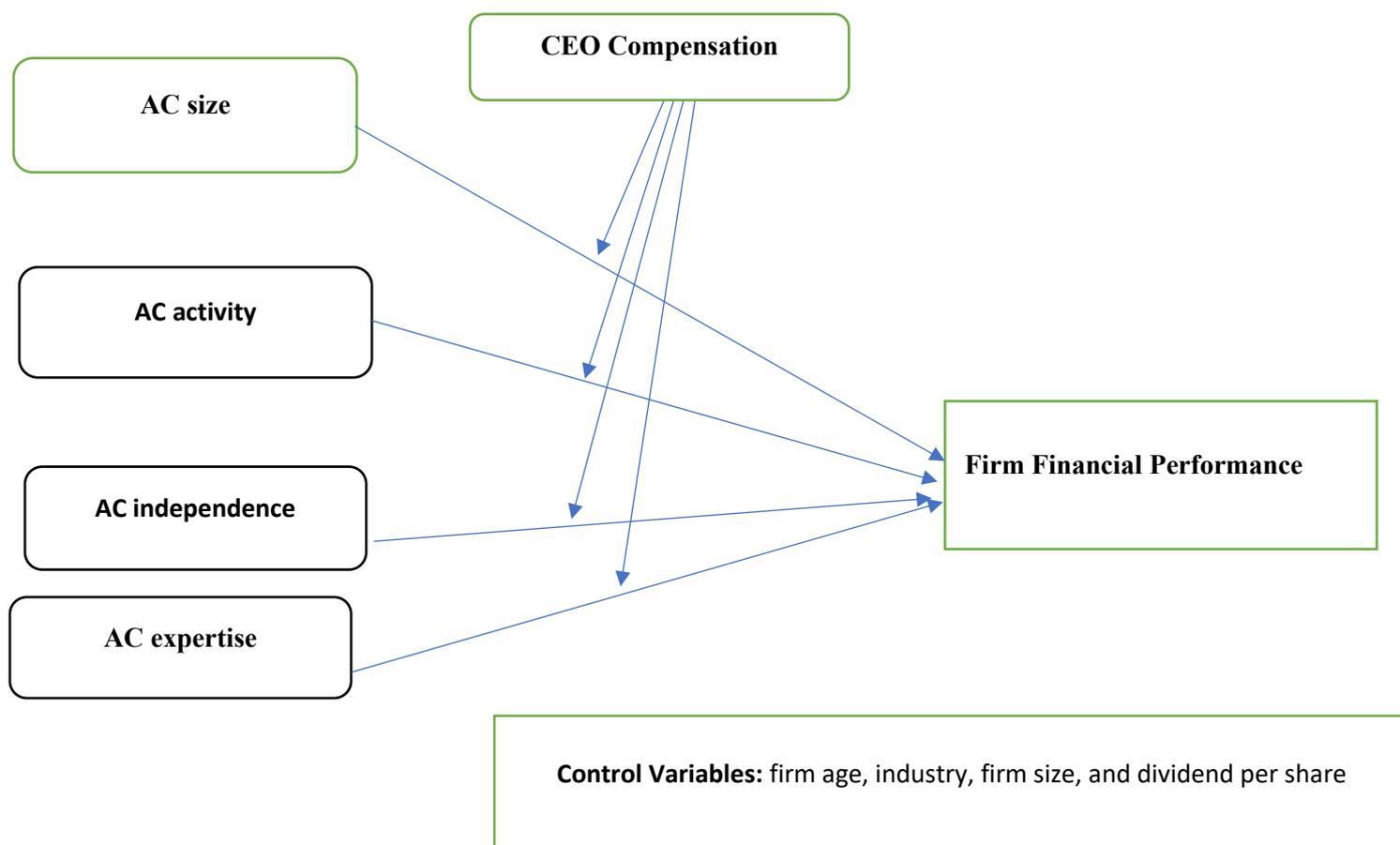


Figure 1 The design of the prospect framework between Audit Committee Characteristics and Firm Financial Performance and CEO Compensation as the moderator variable

Conclusion

The objective of the study is to examine the relationship between audit committee characteristics (AC size, AC activity, AC independence, AC expertise) on Firm Financial Performance. Furthermore, the study also identifies the influence of CEO compensation as a moderating variable on this relationship. It will contribute to the field's literature through providing new evidence on the association between AC with firms' performance and filling an international gap in previous literatures by selecting CEO Compensation as the moderator variable on the relationship between audit committee characteristics and Firm Financial Performance. Previous studies had never selected such a variable. This option has not been investigated in either developed or developing countries, including Jordan. This study's contribution will enrich and expand the international literature on Corporate Governance Mechanisms and firm performance.

Finally, this study will help managers and policymakers improve their efficiency and protect their firms from failure in such an environment with limited access to external funding and a strong impact of firm performance on overall economic growth and welfare. Regulatory bodies like the Amman Stock Exchange (ASE) financial institution management, as well as academic researchers.

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