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The impact of corporate governance mechanisms on financial performance An applied study of a sample of banks in Iraq for the period (2010-2020)

Ali Muzahim Habib[1] , Amer Sami Abd[2] , Anis Bu Obeid[3]

[1] *Business Administration Department, Faculty of Administrative and Financial Sciences, Al-Kitab University, Iraq.*
[2] *Business Administration Department, Al-Hadba College, Iraq.*
[3] *Faculty of Economics and Management, University of Sousse, Tunisia.*
[1]Ali.m.habeeb@uoalkitab.edu.iq , [2]Amersime67@gmail.com , [3]anisbouabid@gmail.com

Abstract

In recent years, interest has increased in the concept of corporate governance and on all sectors, and the banking sector in particular, due to the importance of its role in enhancing and improving financial performance, enhancing disclosure and transparency, and providing reliable financial statements. In its theoretical framework, the study aimed to present a conceptual approach to corporate governance and its importance, as well as the concept of financial performance, and then to know the extent of the impact of corporate governance represented by its internal mechanisms (board independence, executive director compensation, and internal audit) on financial performance.
In its analytical aspect, the study concluded that the relationship between corporate governance and financial performance is a positive relationship, and that governance mechanisms have a direct impact on financial performance.

Keywords: Corporate Governance, Bank Governance, Financial Performance, Company Performance.

Introduction

The concept of governance by international organizations has become of great interest, such as international organizations, including (OECD) and companies as well because of its potential positive effects such as creating an appropriate investment environment. It helps economic institutions achieve their goals by improving their ability to exploit their resources, and improving the financial performance of these institutions and many other positive aspects that ultimately improve the country's economy as a whole.

The concept of financial performance has received an increasing attention because it reflects the company's ability to continue in its work as an indicator of the company's profitability, as high-performing economic institutions are characterized by their ability to efficiently exploit their resources in the long and short term, and their ability to reduce their costs and increase their returns.

Thus, it is clear that the financial performance plays an important role for the company, as does the application of governance mechanisms.

The Research Problem

The impact of the application of governance mechanisms in the banking sector is still weak, which is reflected on the financial performance of the bank, and the following sub-questions emerge:
1- What is the degree of application of corporate governance principles in Iraqi banks listed in the stock market?
2- What is the level of financial performance of Iraqi banks listed in the stock market?
3- What is the nature of the relationship between governance and financial performance of Iraqi banks listed in the stock market?

Research Objectives

In light of the study problem and its importance, the study seeks to achieve the following objectives:

1- A statement of the degree of application of corporate governance principles in Iraqi banks listed in the stock market.

2- Identifying the level of financial performance of Iraqi banks listed in the stock market.

3- Monitoring the relationship between governance and financial performance in Iraqi banks listed in the stock market.

The Importance Of Research

The study deals with the impact of governance mechanisms on financial performance as a dependent variable. The study was conducted using some of the Iraqi banks listed in the stock market; Which means verifying the results of previous studies on the relationships between governance and financial performance.

Research Hypotheses

The first hypothesis is there is a statistically significant effect of the independence mechanism of the board of directors on the financial performance of Iraqi banks listed in the stock market.

The second hypothesis is there is a statistically significant effect of the executive compensation mechanism on the financial performance of Iraqi banks listed in the stock market.

The third hypothesis is there is a statistically significant effect of the internal audit mechanism on the financial performance of Iraqi banks listed in the stock market.

The Hypothesis Of The Research

1- The independent variable (corporate governance mechanisms): It consists of four sub-variables mechanisms: (the board of directors' independence mechanism, the executive director's compensation mechanism, and the internal audit mechanism).

2- Dependent variable (financial performance): It consists of three sub-variables: (rate of return on investment, profit margin, return on assets).

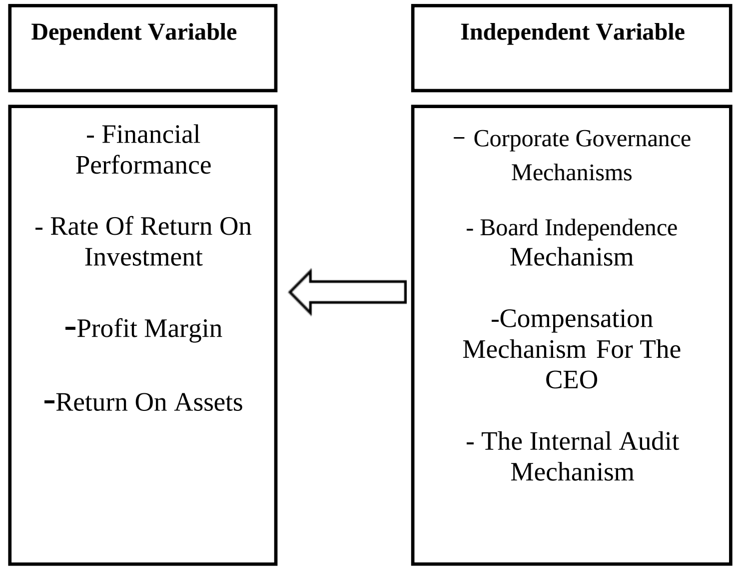

Figure 1. Study model

The Limits Of The Study.

A. Objective limits: The current study deals with the impact of banks' governance mechanisms on financial performance.

B. Spatial limits: The study is applied using some of the Iraqi banks listed in the stock market.

C. Temporal limits: The study tests the assumed relationships between its variables using the data of Iraqi banks listed in the stock market for the period (2010-2020).

Previous Studies

Müller (2014) aimed to examine whether there is a relationship between the governance mechanisms represented by the size of the board, the independence of the board, the ownership of foreign investors, the duality of the first executive director, the gender of the board member, the average service provided by the board members, the ages of the executive administrators, the number of years of service for the chairman of the board and the size of the company. On the value of the facility measured by the ROA for the current year and the ROA for the next year, the study found a positive, statistically significant relationship between (the size of the board, the independence of the board, the ownership of foreign investors and the duplication of the role of the first CEO) and the number of board members and the value of the facility for the current year measured by the return on assets ROA.

Saha and Kabra (2019) selected the impact of some governance features such as the size of the board of directors, the independence of the board, the dual role, the diversity of the board between genders, the concentration of ownership, and the independence of the audit committee on the company's performance. It concluded that there is a significant positive impact of the variables of the size of the board of directors, the concentration of ownership and the independence of the audit committee on the market performance of the company, and the existence of a negative impact of the variable of the independence of the market board of directors of the company, while there is no correlation for the variables of dual role and gender diversity with performance.

Amole, Muo, and Lawal (2021) revealed the impact of corporate governance (board size, board composition, and flour committee) on financial performance (return on assets). Its results found a statistically significant impact of governance on the financial performance of banks, and indicated that the large size of the board, the composition of the board, and the size of the audit committee had a negative impact on the banks' performance.

A Conceptual Introduction To The Mechanisms Of Corporate Governance And Financial Performance

The concept of governance mechanisms:

The application of the principles of governance requires the availability of mechanisms that will ensure the effectiveness of the decision-making process and maximize the value of companies. Moreover, the expansion of capital markets since the beginning of the nineties, the increase in the number of companies listed in the financial market, and the globalization of investment operations has led to the emergence of the need for mechanisms for corporate governance(Cuervo, 2002).

Governance mechanisms are defined as the set of processes that help the company adapt to the variables of its external environment by controlling the variables of its internal environment. Of course, the purpose of governance mechanisms, regardless of their type, is to address problems arising from the agency principle (Cuervo, 2002). It should be noted here that governance mechanisms do not work alone, but rather collectively; This means that only one mechanism, such as that of the Board of Directors, cannot be relied upon(García-Sánchez, Hussain, Khan, & Martínez-Ferrero, 2022).

Referring to the theoretical literature in order to identify the mechanisms of internal and external corporate governance, it is clear that a large number of studies refer to these mechanisms. The following is a presentation of a group of those studies.

Al-Swerki (2021)conducted a study with the aim of identifying the impact of governance mechanisms on disclosure by application on some industrial companies listed on the Palestinian Stock Exchange. The researcher used three mechanisms of governance: the independence of the board of directors, the size of the board of directors, and the concentration of ownership.

Al-Nassira, Hamidatou, and Al-Tayeb (2021) revealed the role of governance mechanisms in practicing accounting conservatism using some of the companies registered on the Algerian Stock Exchange. Mergers and Acquisitions, External Audit, Legislation and Laws.

Alloun (2019) aimed to define the contribution of governance mechanisms as the most important tools for protecting companies and ensuring their stability in achieving the quality of the information contained in the financial statements, using some of the administrative staff working in a group of Algerian companies. The study classified governance mechanisms into two types: internal governance mechanisms (the board of directors and its committees such as the Remuneration Committee, the Audit Committee, and the appointment committees), and external mechanisms (competition in product markets and the administrative business market, legislation and laws mechanism, transparency and disclosure mechanism, and external auditor mechanism).

The concept of financial performance

Five entrances can be distinguished to define the performance of the company in general, which are: the goal entrance, which describes the performance of the organization through its ability to achieve its goals, and the resource entrance, which defines performance through the ability to provide resources and exploit them efficiently, in addition to the ability to adapt to the data of the external environment to ensure the continuity of obtaining. The organization obtains the resources it needs, and the entrance to the operations that sees performance through the lens of the activities carried out by the organization to transform its inputs into outputs. As for the fourth entrance, it is the entrance of stakeholders and takes into account the internal and external environments, as it includes employees, customers, suppliers, creditors, the government, and other stakeholders. Finally, the competing values approach, which describes the company's performance through its ability to achieve the expected values in light of the multiplicity of stakeholders' expectations that the company must achieve.

The company's performance is usually classified into two types: financial performance and operational performance, and each of these two types has its own indicators used to measure it(Wouters, Kokke, Theeuwes, & Van Donselaar, 1999). Since the study's interest is financial performance, the operational performance is initially defined in brief, and then the financial performance is identified in detail. Operational performance has been described in the study (Al-Sa'di, Abdallah, & Dahiyat, 2017) with several definitions that show that this concept refers to the outputs resulting from the operational capabilities of internal operations that are characterized by efficiency and effectiveness to provide products at reasonable cost, quality and timely delivery. appropriate, in addition to the flexibility to meet the needs of customers. On the other hand, a set of definitions of financial performance were monitored, including:

Financial performance refers to the return on the company's assets and equity, and the return on assets is defined as the ratio of net income to total assets, while return on equity is the ratio of net income to shareholders' equity(Pantea, Gligor, & Anis, 2014).

Financial performance is defined as the company's ability to efficiently use its resources in the long and short term to achieve wealth. This definition applies to the financial performance of banks, as it is defined as the bank's ability to use its financial resources efficiently in order to achieve its goals, including profitability(Jagroudi, 2020).

Financial performance is described as the company's ability to generate profits as measured by return on assets (ROA), which is measured as the ratio of EBITDA to book value of total assets (Hassan & Ahmed, 2018).

The relationship between the board of director mechanism and financial performance

The financial performance of economic units can be judged as good or not good through their financial statements, but in fact it is not enough just to look at the financial statements to judge their financial performance, as it is necessary to take other factors that affect their financial performance, and this prompted many From economic units to control provisions, and the nature of the relationship of corporate governance mechanisms to financial performance can be identified by presenting the nature of the theoretical relationship between each of these mechanisms as independent variables and financial performance.

- The relationship between the independence mechanism of the Board of Directors and financial performance.

The availability of independent members of the board of directors through which it is possible to shine and monitor the executives, which would increase the financial performance by reducing agency costs, here is an important mechanism to protect the interests of stakeholders Makki and Lodhi (2013)and AlQudah, Azzam, Aleqab, and Shakatreh (2019) concluded that it aimed to study the impact of the characteristics of the board of directors on the performance of Jordanian banks. The results concluded that the only variable that has a significant positive impact on the financial performance is the size of the board, and the meetings and independence of the board of directors are closely related to the return on assets.

- The relationship between the executive director's compensation mechanism and financial performance.

This mechanism works to harmonize the interests of shareholders and executives so that these interests are compatible and is known as the mechanism that seeks to integrate the interests of managers and owners through salaries, bonuses and compensation for long-term incentives, as these compensations motivate managers to achieve the interests of the company and when managers. By performing their work properly, this will lead to an increase in the value of the company. Compensation is defined as a set of benefits that the company grants to members of the board of directors and executives in return for their efforts in performing the tasks entrusted to them in the company. The strategic decisions of the CEO are complex and atypical, so the supervision Al-Mubasher may not be suitable for performance appraisal(AL-jzraoui & Khudair, 2014)

- The relationship between the internal audit committee mechanism and financial performance.

The Audit Committee plays an important role in improving the value of the economic unit, and this is achieved through the application of corporate governance principles, and the principles of corporate governance enable the Audit Committee to work independently to perform its duties carefully and professionally, and the Audit Committee monitors the mechanisms that improve the quality of information flow between Shareholders and managers, which in turn helps reduce agency problems and this leads to an increase in the value and profitability of the economic unit(Gill & Obradovich, 2012), and if such results are achieved, this means a higher level of company performance. This principle requires that the company conduct an annual independent audit to obtain an external opinion that clarifies the company's financial efficiency and the reliability of its internal reports in order to estimate potential risks in the future and evaluate future benefits(Mostepaniuk, 2017).

It is clear from the foregoing that there is justification for assuming that corporate governance, with its principles of providing a mechanism for the independence of the Board of Directors, compensation for the CEO, and the internal audit mechanism, has a positive impact on improving the performance of companies.

The Second Topic

Society, method and results of the study and hypothesis testing

The researcher deals in this topic with the objective of the applied study, the method and methodology of the study, the measurement of the study variables, as well as the sources of data collection.

The Society And Method Of Study

1- The objective of the applied study

The applied study aims to determine the correlation and influence relationships between corporate governance mechanisms (board independence, CEO compensation mechanism, internal audit mechanism) and financial performance (rate of return on investment, profit margin, rate of return on assets) in Iraqi banks listed on the Iraqi Stock Exchange. During the period from (2010-2020).

2- The method and methodology of the study

This study is one of the field studies in which the researcher follows the quantitative method, with the aim of knowing the impact of corporate governance mechanisms on financial performance, based on the content analysis method, in agreement with many studies, as the informational content of the published financial reports for a sample of Iraqi banks listed in the market was analyzed. Iraq Securities and for the period of the year (2010-2020).

3- The study population and its sample

The study population consists of all (41) banks listed in the Iraq Stock Exchange. A sample of the commercial banks listed in the market was selected, and it consisted of (12) banks, i.e. (29%) of the total banks listed in the Iraqi Stock Exchange, and for a period of ten years extending from 2010 to 2020. Banks because of their active role in the Iraqi economy.

4- Statistical Analysis Methods

The study uses statistical analysis program (EViews) to conduct statistical analyzes and all the results in the tables are prepared by this program by the researcher.

The Results Of The Study

After reviewing the study methodology, this topic dealt with the applied study, which consists in discussing the results and testing the hypotheses.

The first hypothesis: There is a statistically significant effect of the independence mechanism of the board of directors on the financial performance of the banks listed in the Iraq Stock Exchange.

In order to test the above hypothesis, it is required to form the hypothesis for the test, which is as follows:

The null hypothesis (H0): There is no statistically significant effect of the independence mechanism of the board of directors on the financial performance

- The alternative hypothesis (H1): There is a statistically significant effect of the independence mechanism of the board of directors on the financial performance

Table (1). below shows the results of hypothesis testing:

Table (1). of the impact analysis values of the variable of the independence mechanism of the board of directors in the financial performance

Sig.	**Confidence Interval 95%**		**S.E.**	**Estimate**	**influential variable**	**Impact path**	**influential variable**
	Upper Bound	**Lower Bound**					
sig.	0.000208	3.57E-05	5.21E-05	0.000122	Financial performance	< -----	Board independence mechanism

Through the above table (1), which shows the values of the standard regression coefficients, the confidence limits and the test significance, it is noted that the value of the regression coefficient due to the variable of the independence mechanism of the board of directors amounting to (0.000122) was positive, which indicates that there is a direct relationship between the variable The independence mechanism of the board of directors and the financial performance variable, and that the true value of this coefficient ranges between the lowest and highest values (3.57E-05) and (0.000208), respectively, with a standard error (S.E.) of (5.21E-05), and the test appeared to be incorrect. Sig. That is, there is a significant effect between the variable of the independence mechanism of the board of directors and the variable of financial performance. The second hypothesis: There is a statistically significant effect of the compensation mechanism of the CEO on the financial performance of the banks listed in the Iraq Stock Exchange.

In order to test the above hypothesis, it is required to form the hypothesis for the test, which is as follows:

- The null hypothesis (H0): There is no statistically significant effect of the compensation mechanism of the CEO on the financial performance.

- The alternative hypothesis (H1): There is a statistically significant effect of the compensation mechanism of the CEO on the financial performance.

Table (2). below shows the results of hypothesis testing:

Table (2). values of the impact analysis of the executive director's compensation mechanism variable on financial performance

Sig.	Confidence Interval 95%		S.E.	Estimate	influential variable	Impact path	influential variable
	Upper Bound	Lower Bound					
Non sig.	0.028354	-0.05377	0.024797	-0.01271	Financial performance	< -----	Executive Director's Compensation Mechanism

Through the above table (2) that shows the values of the standard regression coefficients, the confidence limits and the test significance, it is noted that the value of the regression coefficient due to the variable of the compensation mechanism of the CEO amounting to (-0.01271) was negative. This indicates that there is an inverse relationship between The executive director’s compensation mechanism variable and the financial performance variable, and that the real value of this coefficient ranges between the lowest and highest values (-0.05377) and (0.028354), respectively, with a standard error (S.E.) of (0.024797), and the test appeared insignificant Non Sig. That is, there is no significant effect between the executive director's compensation mechanism variable and the financial performance variable.

The third hypothesis: There is a statistically significant effect of the internal audit mechanism on the financial performance of the banks listed in the Iraq Stock Exchange.

In order to test the above hypothesis, it is required to form the hypothesis for the test, which is as follows:

The null hypothesis (H0) is there is no statistically significant effect of the internal audit mechanism on financial performance

- The alternative hypothesis (H1) is there is a statistically significant effect of the internal audit mechanism on the financial performance.

Table (3) below shows the results of hypothesis testing:

Table (3). values of the impact analysis of the audit mechanism variable on financial performance

Sig.	Confidence Interval 95%		S.E.	Estimate	influential variable	Impact path	influential variable
	Upper Bound	Lower Bound					
sig.	0.304485	0.225275	0.023916	0.26488	Financial performance	< -----	Audit mechanism

Through the above table (3), which shows the values of the standard regression coefficients, confidence limits and test significance, it is noted that the value of the regression coefficient due to the internal audit mechanism variable amounting to (0.26488) had a positive sign. So, there is a direct relationship between the mechanism variable The internal audit and the variable of financial performance, and that the true value of this coefficient ranges between the lowest and highest values (0.225275) and (0.304485), respectively, with a standard error (S.E.) of 0.023916, and the test appeared significant Sig. That is, there is a significant effect between the internal audit mechanism variable and the financial performance variable.

Findings and Recommendations

The Results:

1- The mechanisms of corporate governance (the board of director mechanism, the board of director independence mechanism, the executive director compensation mechanism, the internal audit mechanism) are the mechanisms related to protecting the rights of all stakeholders. They are internal mechanisms concerned with the company's activities through its board of directors and its affiliated committees such as the audit committee, and the Remuneration Committee, and thus help companies to succeed and continuity in the market by raising the level of their overall performance.
2- When finding the effect between a variable of the independence mechanism of the board of directors and the variable of financial performance, it appeared that there is a significant effect between the variable of the independence mechanism of the board of directors and the variable of financial performance.

3- When finding the effect between a variable of the executive director's compensation mechanism and the variable of financial performance, it appeared that there is a significant effect between the variable of the executive director's compensation mechanism and the variable of financial performance.

4- When finding the effect between a variable of the internal audit mechanism and the variable of financial performance, it appeared that there is a significant effect between the variable of the internal audit mechanism and the variable of financial performance.

Recommendations

1- The necessity for the management of banks to give reassurance to building a culture of governance among employees through the implementation of administrative frameworks.
2- The necessity for the Securities Commission to oblige all Iraqi companies registered under the Iraqi Companies Law to apply banking rules, controls and policies for corporate governance, and to stop trading shares of companies that are not committed to these rules and controls, in order to ensure that the shareholders' hopes are preserved.
3- The necessity of conducting continuous training courses for workers in the field of securities, especially to familiarize them with the principles of corporate governance and the requirements of disclosure and transparency issued under them,
as well as to benefit from the experiences of developed countries in applying the principles of corporate governance in general and governance mechanisms in particular.
4- The necessity of obligating Iraqi companies whose shares are traded in the Iraqi Stock Exchange to prepare interim reports (half or quarterly) and not be satisfied with annual reports, in order to speed up the delivery of information to users.
5- Re-applying the study to other sectors listed in the Iraqi Stock Exchange, to identify the impact of corporate governance mechanisms on the market value and the extent of their application to these sectors.

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