



Is Corporate Governance Important for Financial Performance? Evidence from Jordanian Small and Medium Enterprises

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ABSTRACT

Small and medium enterprises (SMEs) often face challenges such as financial losses, inefficient management, and the absence of formal structures, leading to shorter operational lifespans. To address these issues, corporate governance has emerged as a critical solution. This study investigates specific components of corporate governance namely, an efficient management board, accounting credibility, internal controls, external audits, and sound operational practices and assesses their collective impact on the financial performance of SMEs in Jordan. These components were consolidated into three key dimensions to explore their influence comprehensively. Data were collected from 384 SMEs through structured questionnaires administered to executives and board members. This innovative approach helps address the common challenge of data reliability for SMEs. A key contribution of this research is the integration of agency theory, stewardship theory, resource dependency theory, stakeholder theory, the democratic perspective, and socio-economic theory into a cohesive framework. The findings underscore the substantial role of corporate governance in enhancing the financial performance of SMEs. These insights offer practical implications for policymakers and SMEs owners, emphasizing the adoption of corporate governance to improve financial outcomes. Moreover, this study lays the groundwork for future researchers to validate and expand the proposed model within the context of other emerging economies.

JEL Classification: G34, L25, L26

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INTRODUCTION

Small and medium enterprises (SMEs) are widely recognized as a source of innovation (Majali et al., 2022), as well as drivers of entrepreneurship and competitiveness (Khan et al., 2021). The superior performance of SMEs is essential for stimulating growth and alleviating poverty, especially in developing countries (Asad et al., 2023). SMEs serve as a platform for entrepreneurs to nurture their skills (Kanaan et al., 2024). Over time, these enterprises often grow to become large businesses, contributing significantly to GDP and exports. On average, SMEs contribute to 45% of new job creation in the economy (Chege and Wang, 2020). The growth and survival of SMEs are crucial for the economic development and stability of any country, as these businesses play a significant role in job creation, income generation, innovation, and poverty alleviation. Therefore, their sustainability and success cannot be overlooked, as their failure could have far-reaching consequences for broader economic growth and social welfare.

In Arab countries, SMEs are integral to the economic landscape, driving job creation, innovation, and economic growth (Satar et al., 2023). They contribute approximately 25% to 40% of GDP (Tagliapietra, 2019) and represent up to 90% of businesses in the MENA region (Nasrallah and Khoury, 2022). Given their significant economic impact, effective governance of SMEs is essential. However, their potential remains underutilized due to structural challenges and governance issues. Despite several efforts by governments in Arab countries, access to finance remains a prominent barrier, with limited banking penetration and high collateral requirements restricting the growth of SMEs. Moreover, complex licensing procedures and bureaucratic inefficiencies further hinder the growth of the sector. Additionally, SMEs often struggle to integrate digital solutions (Damer et al., 2021), limiting their competitiveness in a rapidly evolving global market. The rise of fintech and e-commerce offers new avenues for SMEs to scale and access untapped markets. However, due to a lack of leadership support and governance, SMEs in these countries face challenges in adopting fintech and e-commerce solutions (Aljuwaiber, 2021).

Similarly, SMEs in Jordan encounter comparable challenges. Although they form the backbone of the Jordanian economy which account for over 90% of businesses and playing a vital role in employment and GDP, their growth remains sluggish compared to their counterparts in other regions (Kanaan et al., 2024). SMEs in Jordan operate across various sectors, however, despite their importance, they face significant challenges that constrain their growth and innovation potential, with weak governance identified as a major factor contributing to their poor and declining performance (Ta'Amnha et al., 2024). Furthermore, access to funding remains a critical challenge, as stringent lending requirements and high interest rates create substantial barriers for SMEs (Alkhuzai et al., 2024). Compounding these issues are complex registration and licensing procedures that impede business expansion, along with high energy costs and limited adoption of digital technologies, all of which undermine SMEs' productivity and competitiveness (Al-Weshah et al., 2022). To address these challenges, several initiatives have been introduced, including support programs through the Jordan Loan Guarantee Corporation (JLGC) and funding schemes provided by the Central Bank. Although these efforts have notably benefited early-stage startups and young SMEs, a substantial number of SMEs continue to struggle with survival (Eggers, 2020).

Additionally, the government is placing greater emphasis on accounting standards and governance principles (Alodat et al., 2022). While SMEs in Jordan have begun adopting corporate governance practices to enhance decision-making (Alshira'h et al., 2021), their performance and longevity continue to decline (Ta'Amnha et al., 2024). Good governance is widely seen as important for business success, especially when tied to financial reporting (Cooray et al., 2020; Dragomir and Dumitru, 2023). However, research has not yet clearly shown how board characteristics affect financial performance in SMEs.

Several studies have analyzed the influence of corporate governance practices on financial performance in the Middle East and North African (MENA) region. However, research on SMEs remains limited. Moreover, the existing studies relied on secondary data, which is often unreliable in the case of SMEs. Additionally, most studies addressing the banking sector and SMEs have either ignored corporate governance or failed to grasp its significance in linking the two. Studies conducted on the corporate and banking sectors are based on the premise that good corporate governance systems provide businesses with a variety of advantages, such as reduced capital costs, improved performance, and easier access to financing facilities (El Ghoul et al., 2018; Suhadak et al., 2018; Khalil et al., 2018). Moreover, research highlights that strong corporate governance practices, combined with effective information technology systems, internal processes, policies, and procedures, enhance the banking sector's market share by improving its reputation (Alqallaf and Alareeni, 2018). Additionally, studies have established a connection between corporate social responsibility and corporate governance (El-Bassiouny and El-Bassiouny, 2019; Ratmono et al., 2021; Zaman et al., 2022). Alqallaf and Alareeni (2018) further linked these practices to intellectual capital

disclosure, which increases compliance, reduces financial statement manipulation, and helps mitigate fraud (Alkazali et al., 2021).

Research on SMEs in the MENA region, particularly regarding financial performance, varies significantly in methodology, especially in data collection (i.e., primary versus secondary). It has been noted that the lack of corporate governance implementation is a key factor inhibiting SMEs from expanding into large enterprises (Saidat et al., 2019; Thanh et al., 2021). Therefore, there is a need for a new study on corporate governance that address data reliability concerning SMEs in the region. Jordan, being a hub of SMEs, has been chosen for this study, as its SMEs possess proper board structures and follow corporate governance principles in line with government instructions. However, this sector remains underexplored by researchers, prompting the present study to evaluate SMEs financial performance through the lens of corporate governance using primary data.

BACKGROUND OF THE STUDY

Corporate governance issues have traditionally been associated with large corporations (Saidat et al., 2019), while SMEs have often been overlooked due to the assumption that they face minimal agency problems, as owners typically serve as directors (Bahta et al., 2021). However, several authors argue that the size of a business is immaterial and that corporate governance practices are equally important for businesses regardless of size (Puni and Anlesinya, 2020). Similarly, Nazir and Afza (2018) claimed that businesses, whether small or large, can enjoy comparable benefits through the implementation of effective corporate governance practices. These benefits may include improved access to finance, enhanced investor confidence, better risk management, and long-term value creation. Thus, the emphasis is placed not on the size of the enterprise but rather on the quality and consistency of governance frameworks adopted across all levels of operation.

Over the past decade, concerns have emerged about the implementation of corporate governance in SMEs, given their crucial role in economic activity and job creation in both developing and developed economies (Asif et al., 2021; Asad et al., 2022). In the Arab world, state-owned enterprises dominate, setting SMEs and family-owned businesses apart from their counterparts in industrialized nations, where corporate governance standards are already well established (Gal et al., 2019). However, in the past two decades, corporate governance has gained traction in the Arab world, with various initiatives launched to address governance challenges in the region. For instance, in 2003, the World Bank's Global Corporate Governance Forum, in partnership with the Center for International Private Enterprises (CIPE) and local partners, launched a project to assess corporate governance in Egypt, Lebanon, and Jordan. In Jordan, the Jordan Strategy Forum (JSF) prioritized the implementation of corporate governance across both the public and private sectors in the mid-2000s. This initiative established a foundation for developing governance frameworks tailored to the needs of family-owned businesses, state-owned enterprises, and SMEs. Through this approach, Jordan underscored the importance of corporate governance, recognizing it as a key factor for business survival and growth. In 2015, the JSF has established a non-profit organization that represent a group of Jordanian private sector firms which are deeply involved in promoting economic growth and development in Jordan. The organization also provides member firms with opportunities to engage in dialogues with the public sector and connect with decision-makers, thereby increasing awareness and promoting harmony among various groups.

Although the Jordanian economy relies heavily on SMEs, several challenges impede the study of SME markets, including a lack of both financial and non-financial data, as well as informational asymmetry (Al-Hakim et al., 2021). On a global scale, a key issue facing SMEs is the absence of a formal database. To address this, a model has been developed to align corporate governance practices at the SME level, considering organizational structures, situational factors, and external influences. Given the crucial role of SMEs in Jordan's economic growth and development, along with the growing emphasis on corporate governance, this study seeks to investigate the impact of corporate governance structures on the financial performance of Jordanian SMEs. The goal is to examine the relationship between corporate governance and the financial performance of SMEs in Jordan.

REVIEW OF LITERATURE

The major concern regarding the implementation of corporate governance practices relates to two opposing theories that provide different directions for achieving superior performance. The first is agency theory, which

is commonly used in corporate governance research, and the second is stewardship theory. Agency theory that emphasizes on a strong check-and-balance mechanism has always been a major concern for corporations (Almansour et al., 2016). The theory suggests that stringent mechanisms can help control fraudulent activities and ensure that both employees and top management remain focused on achieving corporate goals (Fernando, 2013). In contrast, stewardship theory highlights the loyalty of top management in driving superior performance and suggests that excessive checks and balances can diminish motivation, thereby reducing overall performance (Quinn et al., 2018). These theoretical debates inspire further research in the field. Building on the theoretical gaps identified in corporate governance (Nguyen et al., 2020; Alhossini et al., 2021; Lu et al., 2022), this study aims to contribute to the existing body of knowledge by focusing on the key variables most relevant to SMEs. It is essential to identify mechanisms specific to SMEs that can further advance the theoretical understanding of corporate governance.

Financial Performance of SMEs in Jordan

In the aftermath of the COVID-19 pandemic, developing countries encountered significant challenges regarding the survival and sustainability of SMEs (Fadhel et al., 2022). Analysing the financial performance of SMEs and its impact on national and international economic scenarios became imperative (Asad and Ahmed, 2024). As family businesses dominate the SME sector in the MENA region, the inaccessibility of financial data becomes a major challenge (Asad et al., 2022). In the Arab world, family, relatives, and tribal networks are often given top priority as sources of social sustenance and business prospects (Arayssi et al., 2020; Satar et al., 2024). In this region, business secrets are prioritized, leading to the avoidance of financial reporting to reduce competition and minimize heavy tax burdens, a frequent practice in Jordan (Shakkour et al., 2021). As a result, relying on secondary data for accurate results is unrealistic in the Arab market, especially in Jordan, where high tax rates lead to widespread unreliability of financial data. Consequently, conclusions based on such data may be misleading. SMEs in the region primarily depend on owners' investments, highlighting the need for financial inclusion (El-Halaby et al., 2018). This emphasizes the necessity of primary data collection rather than relying on secondary, unreliable data.

Corporate Governance in Jordanian SMEs

The ability of firms to adapt their strategies to the changing external environment and leverage internal resources is the primary outcome of sound corporate governance (Goodstein and Boeker, 1991). For SMEs, adopting corporate governance practices is particularly beneficial, as it enhances internal controls and fosters transparency. SMEs that implement these practices tend to exhibit stronger internal audit mechanisms, which in turn contribute to superior strategic positioning, better decision-making, and sustainable growth (Tumwebaze et al., 2018; Ali et al., 2018). However, most of the existing research on corporate governance has primarily focused on large organizations, particularly banks, with limited attention given to SMEs (Al-Hakim et al., 2021; Alkazali et al., 2021; Wright and Siegel, 2021; Zaman et al., 2022). The focus on larger firms has led to a gap in understanding how corporate governance practices impact smaller enterprises, especially family-owned businesses and closely held firms, which often have concentrated ownership structures (Fama and Jensen, 1983). As a result, family businesses, which dominate the SME sector in many regions, have been overlooked in the corporate governance literature, despite their critical role in the economy.

However, recent literature has challenged this conventional view (Wright and Siegel, 2021). Contrary to the long-held belief that corporate governance is primarily relevant to large corporations, these studies have suggested that family-run SMEs governed by a formal board of directors tend to perform better and achieve greater long-term sustainability (Basco and Voordeckers, 2015; Saidat et al., 2019). This improved performance is attributed to the collective decision-making process, where diverse viewpoints and interests are considered. Such a dynamic often leads to more balanced, reputation-enhancing, and future-oriented decisions (Minichilli et al., 2007; Asif et al., 2021). Moreover, Bartholomeusz and Tanewski (2006) argued that family-owned businesses with centralized control are more inclined to implement corporate governance practices compared to non-family SMEs.

Empirical Literature Review and Hypotheses Development

In emerging and developing countries like Jordan, weak regulatory and legal frameworks for corporate governance often lead to the overlooking of these guidelines (Awain et al., 2022). This issue is particularly evident in Jordan, where most SMEs are family-owned, and majority ownerships are typically with the family.

Consequently, investor protection, minority shareholders, and controlling shareholders have often not been adequately addressed. Accountability, responsibility, and transparency are critical issues highlighted in this research (Sofyani et al., 2022). To address these gaps and improve financial performance, several factors are identified as essential: the presence of an effective management board, credible accounting practices, robust internal audit systems, the role of independent external auditors, and sound operational governance. These elements contribute to strengthening governance structures within SMEs and enhancing their financial sustainability.

Efficient Management Board

To address the reliability concerns commonly associated with secondary data, the researchers adopted an alternative approach by focusing on the qualitative characteristics of SME owners. In environments where financial records and official data are often incomplete, inconsistent, or intentionally obscured due to factors such as tax avoidance or lack of regulatory enforcement, relying solely on secondary data can lead to misleading conclusions. By shifting attention to the qualitative traits of SME owners, such as their managerial experience, educational background, decision-making styles, risk tolerance, and attitudes toward governance and transparency, the researchers can gain deeper insights into the internal dynamics that influence firm performance (Hammami et al., 2021). According to agency and stewardship theories, value creation is the primary responsibility of the board in corporate governance (Cornforth, 2002; Bae et al., 2018; Salvioni and Gennari, 2019). This focus on value creation influences board characteristics and working environments, which in turn affect organizational performance (Minichilli et al., 2009). Meanwhile, stakeholder theory emphasizes the importance of safeguarding stakeholder interests, contributing to a positive firm reputation (Cornforth, 2002). In contrast, dependency theory highlights the board's role as a liaison between the firm and its external environment, helping align strategic decisions with external demands and enhancing the firm's competitive positioning (Cornforth, 2002; Minichilli et al., 2009; Endrikat et al., 2021). Moreover, the democratic perspective emphasizes decision-making based on diverse board views, leading to better decision-making (Van Veelen, 2018).

In the context of SMEs in Jordan, agency issues are less pronounced due to the nature of ownership structures. Most SMEs in Jordan are family-owned, with ownership typically concentrated within a single family (Alkhuzaie et al., 2024). This close alignment between ownership and management helps reduce the classic agency conflict between owners (principals) and managers (agents), as decision-making authority often rests with the same individuals or within a tight-knit group that shares common interests and goals. Ownership structure issues become more relevant when SMEs involve external shareholders or investors who are not part of the founding family. In such cases, conflicts of interest can emerge, requiring stronger governance mechanisms to protect all parties involved. However, this scenario is uncommon in Jordanian SMEs, where external equity participation is limited, and businesses tend to rely more on internal or informal sources of funding.

Efficient management plays a crucial role in identifying strengths and weaknesses in internal controls and adapting to changes in market situations (Ali et al., 2018) with agile boards can make quick decisions, turning threats into opportunities (Doz and Kosonen, 2010). In the case of SMEs, corporate entrepreneurship is a valuable tool for achieving competitive advantage (Covin and Miles, 1999; Black et al., 2006). Corporate entrepreneurship enhances dynamic capabilities, which, in turn, improve the financial performance of SMEs (Kuratko et al., 2001; Yusoff et al., 2013). However, corporate entrepreneurial orientation, which involves experimenting with unproven ideas, entails substantial risk and uncertainty (Putniņš and Sauka, 2019). An efficient management board is essential to navigate these challenges effectively.

Several studies have recognized knowledge management as a key factor in enhancing board members' capabilities (Asif et al., 2021). Higher levels of knowledge significantly enhance the board's ability to contribute to improving financial performance (Asad, 2024b). Experience also plays a vital role in this process as it facilitates the development of a deeper understanding of the firm's dynamics and external market conditions, which can significantly impact the firm's strategic direction (Handzic, 2011; Ba-Awain and Daud, 2018; Awain et al., 2025). Basco and Voordeckers (2015) compared the influence of demographics and behavioral aspects of the board on the performance of family-owned SMEs.

The active involvement of the board in routine activities provides board members with a deep understanding of the company's day-to-day operations. This engagement allows them to gain valuable insights into the firm's operational strategies, such as resource allocation, process efficiency, and the effectiveness of current business

practices. With a thorough understanding of the business's practical workings, board members are better equipped to identify areas that may require improvement or innovation (Asad 2024a). Additionally, this involvement helps establish a stronger connection between the board and the organization's operational challenges and opportunities. By staying actively engaged with routine activities, board members can make more informed, timely, and relevant decisions (Andriani et al., 2019). For superior performance, value creation becomes a critical element, and professional board behavior plays a pivotal role in generating superior value. Changes in board membership can significantly influence the value creation process, as evidenced by research on the impact of succession planning for key board positions (Ali et al., 2018; Puni and Anlesinya, 2020). Succession planning ensures that the board maintains the right balance of expertise and leadership, which in turn can drive long-term growth and value for the organization.

Succession planning is also a crucial issue for SMEs, especially family-owned businesses, where family members often replace board members to ensure the continuity and longevity of the business. Chege and Wang (2020) examined corporate governance practices and found that many SMEs prioritize succession planning over developing specific skills. However, the process of succession has a profound impact on the survival and success of the business, and the absence of a well-defined succession plan is a key factor contributing to the failure of family-owned SMEs because of inefficient management. In this research, the qualitative traits of entrepreneurs are assessed through a questionnaire, providing insights into how their characteristics influence succession planning causing inefficient management. Thus, the proposed hypothesis for identifying the impact of an efficient management board on financial performance is as follows:

H1: An efficient management board has a significant positive impact on the financial performance of SMEs.

Accounting Credibility, Internal Control, and External Audit

An efficient management board is essential but not sufficient for improving firms' performance. SMEs also require credibility in accounting procedures, strong internal controls, and reliable external audits (Rikhardsson and Yigitbasioglu, 2018). Positive accounting theory is strongly associated with a firm's financial performance and long-term performance. It suggests that implementing a sound accounting system, maintaining strong internal controls, and conducting reliable external audits promote transparency, which in turn enhances financial performance (Kwilinski, 2019). These principles are equally applicable to SMEs, highlighting the importance of solid financial governance regardless of firm size. To achieve efficient internal control, managerial accounting and policies play a significant role in enhancing firms' performance (Govindarajan and Anthony, 1998). Therefore, selecting appropriate costing techniques and cost allocation methods and identifying existing weaknesses can enable enterprises to establish efficient systems that enhance overall performance (Alcouffe et al., 2019).

Currently, technological advancements and digital transformations help businesses improve efficiency and strengthen internal controls. In the field of accounting, the implementation of Enterprise Resource Planning (ERP) and Financial Resource Planning (FRP) has reduced human effort and involvement, consequently minimizing the chances of fraud and errors (Alrabba and Ahmad, 2017). Decision-making supported by ERP and FRP positively enhances financial performance due to improved internal control mechanisms (Bavarsad et al., 2013; Zaid et al., 2018).

Internal controls and external audits collectively contribute to financial performance (Tumwebaze et al., 2018). Along with accounting credibility and internal controls, ensuring the reliability and quality of external audits is equally important. The final dimension of this construct is external audit, which needs to be independent and efficient (Zimbelman and Waller, 1999). External auditors play a leading role in identifying errors or fraud, and hence, low-quality external audits negatively influence financial performance (Costandi et al., 2019). Researchers have stressed the importance of the choice of external auditor, as the Big Four are considered the most reliable in terms of fraud detection and avoidance (Davidson and Neu, 1993; Lennox and Pittman, 2008; Nazarova et al., 2020). The Sarbanes-Oxley Act (SOX), enacted in 2002 in the United States, was introduced in response to major corporate scandals (like Enron and WorldCom) to restore public trust in financial reporting and corporate governance. One of its key provisions is the enforcement of strong internal controls, including the implementation of internal audits.

Therefore, in the present study, we aim to focus on all three criteria namely, accounting credibility, internal controls, and external audit reliability. SMEs need to adopt discretionary practices to ensure transparency and disclosure to attract external financing locally or internationally (Alareeni, 2019). Furthermore, to improve financial performance, SMEs need to rely strongly on audited financial statements (Chit, 2019), as reliable audited financial

statements ensure sustainable performance, especially in emerging and developing economies. Considering the above discussion, the following hypothesis is proposed:

H2: Accounting credibility, internal control, and external audit have significant impacts on the financial performance of SMEs.

Sound Operational Practices

Achieving superior performance requires sound operational practices. Successful adoption of these practices requires involvement of all stakeholders. Hence, suppliers, employees, clients, and social stakeholders must contribute to ensure effective operations, which leads to improved financial performance (Kanaan et al., 2024). Corporate governance practices must promote respect for all stakeholders, a goal that can only be achieved with a support from top management (Shleifer and Vishny, 1997). This is also closely related to knowledge management, which involves acquiring and understanding information about all stakeholders of the enterprise (Asif et al., 2021). Knowledge management is widely regarded as a critical driver of sound operational practices, playing a pivotal role in enhancing a firm's overall financial performance. By effectively capturing, organizing, sharing, and utilizing knowledge within the organization, firms can streamline operations, reduce inefficiencies, and make more informed decisions. This leads to better resource allocation, improved process management, and increased adaptability in a dynamic business environment.

Another essential element of sound operational practices is cash management, which significantly influences operational strategies that impact financial performance (Kroes and Manikas, 2014). Schmidt and Wagner (2019) studied and claimed that an efficient supply chain structure influences the acquisition of resources and reduces transactional and operational expenditures. Similarly, network capabilities, including managerial practices employed by enterprises at the structural level, guide management in acquiring or ceasing business contacts for the advancement of the business (Mitrega and Pfajfar, 2015).

Several studies have identified consumer satisfaction as a major determinant of financial performance (Lee et al., 2018). As the primary source of revenue, satisfied consumers contribute to consistent cash inflows, making them essential to a firm's financial success (Khan et al., 2022). Satisfied and loyal customers are fundamental for any enterprise to maximize revenues and minimize operational costs (Gáti et al., 2018). Customer loyalty, driven by customer satisfaction, helps reduce operational costs because the company spends less on customer retention. This can only be achieved through sound operational practices (Anderson, 1998; Lim et al., 2020).

The discussion of sound operational performance would be incomplete without addressing employees' well-being and motivation, which are fueled by positive attitude, commitment, and creativity in the workplace (Chen and Fulmer, 2018; Shafi et al., 2020). To retain human resources and keep them motivated, training, job security, and policies that reward performance all play a significant role in fostering sound operational practices (Bibi et al., 2018; Ekhayemhe and Oguzie, 2018). Building on the previous discussion and the mechanisms that ensure sound operational practices, we have identified the development of a robust supply chain, effective human resource practices, and customer satisfaction as key components of operational excellence. These strong operational practices are linked to superior financial performance. Therefore, the proposed hypothesis is as follows:

H3: Sound operational practices have a significant impact on the financial performance of SMEs.

RESEARCH METHODOLOGY

A well-designed research approach ensures both the reliability and validity of the findings. In this study, a quantitative and causal methodology is employed. The quantitative approach is chosen for its ability to provide reliable results for hypothesis testing, while the causal design focuses on examining and testing established theories.

Sample Selection

The first step in the research process is determining the appropriate sample size. In this study, the population consists of all SMEs operating in Jordan, with the sample selected based on the definition provided by Betz and Frewer (2016). Respondents were chosen using simple random sampling from the list provided by the Small

and Medium Enterprise Development Authority in Jordan. The SMEs are categorized according to several criteria which include the number of employees, annual turnover, and capital investment. Initially, 600 questionnaires were distributed with a response rate of 66.67% (see Table 1). After screening, 384 questionnaires were deemed usable and included in the analysis. The details of the distribution are provided in the following tables.

Table 1 Survey Descriptions

Description	Frequency and Percentages
Total Number of distributed questionnaires	600
Questionnaires returned	400
Response Rate	66.67%
Usable and Complete Questionnaires	384
Discarded and Incomplete questionnaires	16
Effective Response rate	64%

Instrument and Variables of the Study

In research design, the validity of the instrument is crucial as it ensures the credibility of the research (Quinlan et al., 2018). For this study, four constructs were measured, each comprising several dimensions. However, given the level of understanding of the entrepreneurs, the variables were measured in a uni-dimensional manner. The first independent variable of the study is the Efficient Management Board, which is considered a core component of corporate governance. Efficient Management Board was measured using five items adopted from Kavitha et al. (2019). These items assess the efficiency, skills, and expertise of the board members, particularly in relation to their ability to manage risky decisions. The second aspect of corporate governance addressed in the study is Accounting Credibility, Internal Control, and External Audit, measured through six statements adopted from Tumwebaze et al. (2018). The items for this construct covered various dimensions, including the accounting methods used, the internal controls developed to prevent fraudulent activities, and the market reputation of the audit firm, which reflects the credibility of the external audit process. The final component of corporate governance, Sound Operational Practices, was measured using eight items adopted from Rust et al. (2002). This construct included items related to the procedures adopted for decision-making and the systems employed by the firm to ensure smooth operations, timely decision-making, and efficient execution of routine activities.

The dependent variable, financial performance of SMEs, was measured using nine items adapted from Asad et al. (2024). Due to the informality of SMEs and their informal record-keeping practices, the variable was not measured through traditional accounting measures. Instead, it was assessed based on the entrepreneurs' perceptions regarding increases in sales, assets, profitability, cash flow, and employment. The instrument was developed based on established past studies, which minimized the need for face validity testing, as the items were adopted from well-recognized instruments. All variables are measured using a 7-point Likert scale, as most studies using primary data have reported that the 7-point Likert scale is the most reliable (Bilal and Sulaiman, 2021; Qalati et al., 2022; Riphah et al., 2022; Xie et al., 2023; Salem et al., 2023; Javed et al., 2024). However, the reliability and validity of the instrument were still assessed through statistical tests.

Validity and Reliability of the Instrument

To ensure the face validity of the instrument, corporate governance experts first reviewed the questionnaire. Subsequently, Cronbach's alpha was calculated for the entire questionnaire, yielding a value of 0.87, which is considered strong (Newman et al., 2013). To further assess the reliability and validity of the instrument, Average Variance Extracted (AVE), Composite Reliability (CR), and Cronbach's Alpha for each variable were calculated and compared with the threshold values of 0.7, 0.5, and 0.7, respectively (Henseler et al., 2015). Additionally, item loadings for all items were evaluated, and items with loading values below 0.7 were considered for removal from the model (Hair et al., 2013). However, no items were removed, as all items loadings exceeded the 0.7 threshold. Discriminant validity was also assessed using the Fornell-Larcker criterion (Henseler et al., 2015). After confirming that the instrument was free from error, reliable, and valid, structural equation modeling (SEM) was employed to assess the significance of the independent variables in predicting the dependent variable.

RESULTS AND DISCUSSION

In this study, all item loadings were analyzed to identify any problematic item that do not fit within the instrument. Table 2 reveals the item loadings for all the questions. Likewise, all item loading ranges from a lesser bound of 0.714 to a higher bound of 0.953 (see Table 2).

Table 2 Outer Loadings

Items	Accounting Credibility, Internal Control, And External Audit	Efficient Management	Financial Performance of SMEs	Sound Operational Practices
Q10		0.888		
Q11		0.881		
Q12		0.937		
Q8		0.849		
Q9		0.874		
Q19			0.814	
Q20			0.902	
Q21			0.865	
Q22			0.939	
Q23			0.824	
Q25			0.89	
Q26			0.743	
Q28			0.714	
Q41	0.771			
Q43	0.796			
Q44	0.862			
Q45	0.906			
Q46	0.859			
Q51				0.936
Q52				0.724
Q53				0.908
Q54				0.869
Q55				0.953
Q56				0.925
Q58				0.943
Q59				0.895
Q60				0.92

Moreover, the item loadings presented in Table 2 confirm that all items should be retained in the model, as all item loading values exceed 0.7. The calculated item loadings, which are greater than 0.7, indicate that these items are suitable for inclusion in the model. After confirming the item loadings, the next step is to assess the reliability and validity of the instrument. In the current study, Cronbach's Alpha, Composite Reliability, and Average Variance Extracted (AVE) were calculated to evaluate the reliability and validity of the exogenous variables and the financial performance of SMEs. Convergent validity is assessed by examining the relationship of each variable using the Average Variance Extracted (AVE). An AVE value greater than 0.50 indicates significant validity. Cronbach's Alpha, Composite Reliability, and AVE values for the exogenous variables and financial performance of SMEs are presented in Table 3. The findings revealed that the Cronbach's Alpha values for all variables are 0.895, 0.931, 0.939, and 0.970, indicating that all variable values exceed the threshold value of 0.7 (Henseler et al., 2015). Furthermore, the composite reliability values for all variables are 0.923, 0.948, 0.950, and 0.974, confirming that these values are above the recommended threshold of 0.70. Finally, the Average Variance Extracted (AVE) values for all variables are 0.706, 0.785, 0.705, and 0.809, which also confirms that all values are greater than the threshold level of 0.50.

Table 3 Reliability and Validity

Variables	Cronbach's Alpha	Composite Reliability	AVE
Accounting credibility internal control and external audit	0.895	0.923	0.706
Efficient Management Board	0.931	0.948	0.785
Financial Performance of SMEs	0.939	0.950	0.705
Sound Operational Practices	0.97	0.974	0.809

After establishing the reliability and validity, it is crucial to assess discriminant validity. In this study, discriminant validity was examined using the Fornell-Larcker Criterion, which assesses the extent to which items within one construct differ from items in other constructs. According to Hair et al. (2013), the Fornell-Larcker Criterion is one of the most widely used methods for analyzing discriminant validity. Discriminant validity is demonstrated when the square root of the average variance extracted (AVE) for each variable is greater than the

highest correlation with any other latent construct (Henseler et al., 2009). The calculated values for discriminant validity for the exogenous variables and the financial performance of SMEs are presented in Table 4.

Table 4 Discriminant Validity

Variables	(1)	(2)	(3)	(4)
(1) Accounting Credibility, Internal Control, and External Audit	0.840			
(2) Efficient Management Board	0.739	0.886		
(3) Financial Performance of SMEs	0.576	0.687	0.840	
(4) Sound Operational Practices	0.743	0.621	0.629	0.899

After analyzing the outer and structural models using bootstrapping with 500 subsamples, the results of the path coefficients and hypothesis testing are presented in Table 5. The results revealed that all components of corporate governance examined in this study have a significant influence on the financial performance of SMEs. The study utilized the structural equation modeling (SEM) technique and found that an efficient management board has a significant impact on financial performance ($\beta = 0.515$, $T = 3.416$, $P = 0.000$). These findings indicate that an efficient management board positively impacts financial performance, as the collective decision-making process of an effective board leads to timely and market-responsive decisions that drive the success of enterprises. These results align with prior research, which asserts that board efficiency contributes to superior performance (Minichilli et al., 2009; Basco and Voordeckers, 2015; Saidat et al., 2019; Arayssi et al., 2020). They argued that board efficiency is critical to the sustainability and financial performance of any business, regardless of its size. Thus, the current research supports these arguments and further validates the propositions of agency theory and stewardship theory by integrating these two opposing perspectives.

Table 5 Hypothesis Testing

Paths	Original Sample (O)	Sample Mean (M)	Standard Deviation (STDEV)	T Statistics (O/STDEV)	P Values
Efficient Management Board-> Financial Performance of SMEs	0.515	0.496	0.150	3.416	0.000
Accounting Credibility, Internal Control, And External Audit-> Financial Performance of SMEs	0.474	0.433	0.126	3.748	0.000
Sound Operational Practices-> Financial Performance of SMEs	0.364	0.329	0.126	2.890	0.001

Similarly, the result for second construct (i.e., Accounting Credibility, Internal Control, and External Audit) revealed that all dimensions collectively have a significant influence on the financial performance ($\beta = 0.474$, $T = 3.748$, $P = 0.000$). These findings suggest that when accounting statements and policies are credible, the internal control system is strong and efficient, and external auditors are reliable (i.e., preferably from one of the "Big Four"), improved financial performance is outcome. These findings reinforce the concepts within agency theory and align with previous studies such as Bavarsad et al. (2013), Alrabba and Ahmad (2017), Tumwebaze et al. (2018), Alareeni (2019), Chit (2019), Doktoralina and Apollo (2019), among others. Accounting credibility positively influences financial performance by minimizing the chances of fraud and errors. Decisions based on reliable information are more likely to yield favorable outcomes. Likewise, a strong internal control mechanism ensures transparency and reduces the potential for fraudulent activities, thus enhancing the confidence of both customers and investors, which contributes to financial strength and sustainability. Furthermore, if external auditors are reliable, they ensure accurate financial reporting, providing a firm foundation for enterprises. While it is not mandatory for SMEs to be audited by the Big Four, this cost can be considered an asset, as it helps achieve financial performance and fosters investor confidence.

Lastly, sound operational practices also demonstrated a significant positive influence on the financial performance ($\beta = 0.364$, $T = 2.890$, $P = 0.001$). Sound operational practices encompass factors such as customer and employee satisfaction, relationships with suppliers, and the overall supply chain network. The findings emphasize that sound operational practices result from the involvement of all stakeholders within the enterprises. Until all stakeholders play their part, sound operational practices may not be achieved, and financial performance may become challenging. These results are consistent with prior research, which suggests that sound operational practices are essential for superior performance (see Edvinsson, 1997; Kroes and Manikas, 2014; El Ghouli et al., 2018; Gáti et al., 2018; Andriani et al., 2019; Doktoralina and Apollo, 2019; Kwilinski, 2019; Chege and Wang, 2020). However, these findings contradict those of Nasrallah and Khoury (2022), who claimed that sound operational practices do not significantly impact financial performance. While several studies have acknowledged the importance of cash

management, innovation, and the supply chain, these constructs have been analyzed individually. In contrast, the current research integrates them under the broader framework of sound operational practices. By doing so, it contributes to the literature by synthesizing and extending stewardship theory from a democratic perspective and agency theory.

Overall, the model explains 53.9% of variance in financial performance, attributed to the inclusion of three key variables within the corporate governance framework, encompassing more than ten dimensions. The findings offer strong justification for encouraging SMEs to implement effective board management to enhance financial performance. An effective board should oversee the implementation of the other components identified in the study to promote transparency and enhance financial performance. To further validate the findings, the path coefficients were examined, and the predictive relevance of the model was assessed using the Stone-Geisser indicator. This suggests that the inner model should effectively estimate the endogenous latent constructs. (Henseler et al., 2009). Hair et al. (2013) stated that cross-validated redundancy can be evaluated using the Stone-Geisser test, which is calculated using the blindfolding technique. Table 6 presents the result of cross-validated redundancy for the Efficient Management Board, Accounting Credibility, Internal Control and External Audit, Sound Operational Practices, and Financial Performance of SMEs. The result shows that the value of Q^2 is greater than 0 for the financial performance of SMEs (0.347) which confirms that the model has significant predictive relevance. Henseler et al. (2009) stated that a Q^2 value greater than 0 means that the model has predictive relevance whereas, if the value of Q^2 is less than 0 suggests a lack of predictive relevance.

Table 6 Predictive Relevance

Construct	Cross validated Redundancy	SSO	SSE	$Q^2 (= 1 - SSE / SSO)$
Financial Performance of SMEs		792	517	0.347

CONCLUSIONS

The purpose of this study is to identify the corporate governance factors which are important for the performance of Jordanian SMEs. For this purpose, theoretical frameworks such as Agency Theory, Stewardship Theory, Stakeholder Theory, and Sociological Theory were utilized. One of the greatest challenges in studying SMEs is obtaining reliable information, due to their informal organizational structures. SMEs often choose to keep their financial and managerial records private and are less inclined to fully adopt formal corporate governance practices. This reluctance is a key barrier that hinders their potential growth and transition into larger enterprises.

While several studies have focused on corporate governance and financial performance, most of the research has concentrated on banks and publicly listed companies, as these organizations manage public funds. Research on SMEs, particularly in developing economies, remains scarce. Moreover, the few studies conducted in the context of developed countries have primarily relied on secondary data, which, while reliable for developed nations, raises concerns about data availability and reliability in developing countries. This study aimed to uncover the key components of corporate governance that are essential for SMEs operating in developing and emerging economies. To address the issue of data availability and reliability, primary data was collected through a questionnaire. The validity of the instrument was ensured through expert review, while the reliability of the data was confirmed using statistical methods.

This study identified the key factors that significantly influence the success and financial performance of family-owned SMEs and closely held enterprises. It highlighted the internal capabilities that need to be developed and the corporate governance mechanisms that SMEs should adopt to enhance their financial performance. We confirmed that sound management practices, along with robust internal controls, ensure the sustainability and survival of SMEs during challenging times. Consequently, the study encourages SMEs to incorporate effective corporate governance practices to attract both local and international investors.

Despite the valuable findings for SMEs, this study has several limitations. First, the data were collected during the second wave of the COVID-19 pandemic, a period that had a significant impact on the financial performance of SMEs. Second, corporate governance studies often employ panel data to mitigate the limitations of cross-sectional and time-series analysis. In contrast, this study employs the perceptual measures from the board of directors and executives of SMEs at specific points in time. Although the inclusion of negatively worded items in the questionnaire helped reduce self-serving bias, it could not be eliminated.

Despite these limitations, the findings of this study are significant for policymakers and practitioners. It is recommended that the developed model be evaluated and evaluated in other emerging economies, with comparisons made between developing countries that differ significantly in terms of political systems. Additionally, using the same instrument, future studies could be conducted in other Arab countries to validate the accuracy and applicability of the model.

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