Lebanese American University

Corporate Performance and the Perceived Strength of the Legal System: The Role of Corporate Governance

By

Fadi Iskandar

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THESIS APPROVAL FORM

Student Name: Fadi Iskandar I.D. #:

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The undersigned certify that they have examined the final electronic copy of this thesis and approved it in the requirements for the degree of:

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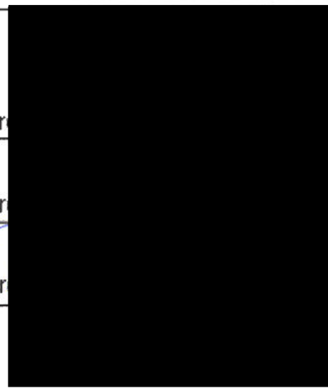

Thesis Advisor's Name Khodr Fakih	Signature	DATE: Day
Committee Member's Name Abdul-Nasser Kassar	Signature	DATE: Day
Committee Member's Name	Signature	DATE: 1/16/2018 Day

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Dedication

I would like to dedicate my work to my parents who have always been the supportive backbone to my life, whether in good or bad. The continuous motivation and gratitude you have shown me is unmatchable.

I would also like to dedicate this to the instructors who taught me throughout my years at the Lebanese American University. Thank you.

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Corporate Performance and the Perceived Strength of the Legal System: The Role of Corporate Governance

Fadi Iskandar

ABSTRACT

Corporate governance is a combination of the specific laws and regulations manifested within the organizational behavior. Throughout this study, the advantages of implementing corporate governance structures within a firm are explained along with their positive effect on business performance. The study primarily aims to illustrate how a nation's perception of the strength of the legal system positively influences financial performance. This relationship is mediated by a variable which is corporate governance.

In general, the objective is to demonstrate that the relationship between the legal system and financial performance is affected by a mediating variable that is corporate governance. Prior research supports this topic and provides examples and explanations regarding the importance of corporate governance and the strength of the legal system. The ruling system serves as the law enforcer as it runs the standards of what is acceptable, thus, affecting the capability and performance of an organization.

Keywords: Corporate governance, financial development, legal system, standards, productivity, perception, awareness

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LIST OF ABBREVIATIONS

SEC	Security Exchange Commission
OECD	Organization for Economic Cooperation and Development
CEO	Chief Executive Officer
BCC	Banking Control Commission
LCC	Lebanese Code of Commerce
OGA	Ordinary General Assembly
BDL	Decision of the Central Bank of Lebanon
CMC	Code of Money and Credit
LTA	Lebanese Transparency Association
LCGTF	Lebanese Corporate Governance Task Force
LCCG	Lebanese Code of Corporate Governance

Chapter One
Introduction

1.1 Overview and Background

Corporate governance has gained great significance and become a controversial topic in the business field. Since the financial crisis of 2008, shocking and outrageous stories have arisen concerning the abuse of position by executives. The system of checks and balances that was set to prevent this misuse failed. Thus, corporate governance was the main issue to be dealt with to avoid future company failures similar to those that took place in recent years such as the failure of the American companies like Enron, Bear Stearns, American International Group and others. This catastrophe also extended to involve international firms such as Parmalat, Royal Dutch Shell, and Siemens. We define corporate governance then as a set of mechanisms that aim to mitigate the problems that arise from the management in a company and its stakeholders, so stakeholders obtain optimal pay on their investment.

1.2 Need for the Study

Usually, in a joint stock company, shareholders invest their money while looking forward that the management safeguard it while making decisions related to the performance and future of that company. This fact creates a specific kind of relationship between the shareholders and the management known as the Principle-Agent relationship. The problem of delegating one party, the agent, to act on behalf of the other, the principle, constitutes the agency problem. In a company, the agency problem refers to the conflict of interest that exists between the shareholders and the management. The managers who are the agents must act in the best way to ensure optimal pay for the

shareholders' investments. The reason that managers are appointed to this mission is due to the skill and experience that they have which permits them to run the company and which the shareholders theoretically lack. Thus, a fiduciary relationship is created between the shareholders and the management; this means that the latter must act in the best interests of the former to implement the designated tasks, keeping in mind that the principal's best interest is the priority. This relationship could lead to a moral hazard between the principal and the agent; the agent cannot be monitored at all times that he is taking his decisions in a way that ensures optimal efficiency for the company. It is up to the managers to decide whether they should exert less energy or consume more prerequisites than stockholders would like. It is also the manager's decision to choose investment, operating, or financial policies that fir their risk or time preferences instead of those of the bondholders (Byrd, 1998). In addition to that, it could lead to adverse selection problem; one party, the agent, has more advantages on controlling information than the other party, the principal. The difference between these two problems is that adverse selection occurs when there is a lack of symmetric information between agent and principal, whereas moral hazard occurs when there is asymmetric information between the two. The costs that result from this agency problem are referred to as agency costs. To lessen these mentioned costs, a monitoring system of checks and balances, known as corporate governance, is put into place within the organization (Larcker, 2011). This monitoring system consists of a Board of Directors that administers the management and an external auditor that checks the accuracy and reliability of financial statements to ensure stockholders' interests. On a larger scale, this system is constituted from other

parties that influence the governance of every company such as the firm's creditors, suppliers, customers, media, regulators such as the SEC and labor unions.

1.3 Research Objective

The goal of this research is to find evidence that a relationship exists between the perception of the strength of the legal system, financial performance, and corporate governance. The pros outweigh the cons when it comes to implementing corporate governance. These advantages act as mediating variables in a relationship between the perception of the enforcement of the legal system and financial performance. The main objective is to support this notion. Another aim is to emphasize the importance of managing governance structures. Corporate governance does not only increase profit and financial performance, yet, benefits the organization as a whole by fabricating a well-structured hierarchy.

1.4 Relevance of Research

The importance of this research is to demonstrate the mediating influence of the corporate governance and its effects on the relationship between the perception of enforcement and strength of the legal system and financial performance. The results signify the importance of implementing governance structures and increasing awareness of the strength of a nation's legal system. Corporate governance is an ethical and lawful implication that can foster growth to an organization and increase its productivity. The legal system plays a role in this as it contributes to being the law enforcer and sets the standards of what is acceptable and what is not. Corporate governance is then effected by the perception and awareness of the legal system that causes a change in financial development.

1.5 Limitations of Research

Although not severe, there are certain limitations to this study. The participant pool (n) is made up of 90 participants. However, 58 participants were targeted, 54 of which fully completed the survey and 4 did not fully complete it. Although a participant pool of 30 is sufficient, 'the more, the merrier' seemed to be a conflict of interest throughout the study as it was difficult to obtain. Nevertheless, n=58 was sufficient for the study and also revealed the results and statistics that correlated with the study's hypotheses. Another limitation was that of location-specific participants as it was limited to Lebanese firms. However, we can generalize our sample to the population and that of similar locations, comparing them to the more efficient systems.

Chapter Two
Literature Review

2.1 Corporate Governance

Corporate governance consists of the mechanisms, procedures, and relationships that regulate, control, and direct organizations. It mainly refers to a combination of the specific set of laws, regulations, and principles manifested within the organizational behavior. It involves such objectives as maintaining the interest of a firm's stakeholders and provides a concrete structure that covers every aspect of management; this includes action plans, measurement of performance, internal controls, and firm disclosure. Modernday discussions in regards to corporate governance bring up three documents released in the early 90's; The Cadbury Report, Principles of Corporate Governance, also known as, Organization for Economic Cooperation and Development (OECD), and the SarbanesOxley Act. The Cadbury and OECD reports reveal the principles that organizations must adopt to assure a firm governance structure. The Sarbanes-Oxley Act is an effort initiated by the US Federal Government to enact the values of the Cadbury and OECD reports. These principles include but are not limited to, the following: "rights and equitable treatment of shareholders, interests of other stakeholders, role and responsibilities of the Board, integrity and ethical behavior, and disclosure and transparency" (Core & Holthausen & Larcker, 1998).

The results of a study conducted by John E. Core, Robert W. Holthausen, and David F. Larcker support the fact that corporate governance can be improved by segregating certain positions such as Chairman and CEO, creating smaller boards, implementing obligatory retirement ages or terms, eliminating gray directors, and specifying a certain limit of boards that a board member may be a part of (Core & Holthausen & Larcker, 1998).

In opposition to other guidelines, no evidence exists that to enhance corporate governance firms must seek to prefer external directors, who supposedly generate a more effecient board, rather than internal ones. Also, no evidence supports the fact that better equity ownership by exterior directors results in enhanced governance systems. The attention given to the relationship between outside directors and stakes seems to be misdirected (Core & Holthausen & Larcker, 1998).

A study conducted by Ahsan Akbar reveals that corporate governance is a leading factor in a significant and positive contribution to firm performance. The corporate governance and organizational performance relationship exists evidently and is of positive correlation. Akbar's study shows that corporate governance is concerned with the strategy of implementing a code that ensures the safety and rights of shareholders (Akbar, 2015). Shareholders want to invest their capital in a firm that guarantees maximum return and safe investments. A business with weak corporate governance has poor transparency, therefore seeming unappealing to shareholders. A firm must increase its governance to improve transparency and attract foreign investors. The Sarbanes-Oxley Act, for example, ensures transparency and proper confession of the financial matters of the organization (Akbar, 2015).

To efficiently implement corporate governance, Akbar states that conventional measures and regulation of directors, along with other procedures, must be applied to achieve an efficient governance structure leading to superior firm performance. These conventional measures are composed of concentrated ownership, a suitable Board size and composition, the disintegration of CEO/Chair duality, and the functioning of audits and other committees

(Akbar, 2015). Director Regulations require educated directors, a mandatory retirement age, the fact that ex-CEO's may not join the Board, annual elections of Board members, compensation of the Director, an oversight of associated party transactions, and an obligation to attend the Board. "Other regulations require accurate CEO compensation, executive performance evaluation, compensation of senior management, and responsiveness to shareholder interest" (Akbar, 2015). Furthermore, Akbar emphasizes the importance of an existing auditor rotation policy, the ability for shareholders to "request special meetings, corporate social responsibility, defined code of ethics, the disclosure of financial information, and disclosure of Executive and Director Compensation" (Akbar, 2015). Only when this criterion is met can an organization properly implement a governance structure that will lead to increased performance (Akbar, 2015). Akbar's research also illustrates the fact that developed countries have better corporate governance structures that result in better firm performance. Developing countries seem to have weaker governance structures. However, they seem to be recently realizing the importance of such mechanisms.

In conclusion, an operational governance structure will force managers to work at higher capacities to maintain the firm's interest of providing precise and clear information. Also, managers will be forced to precisely accept those projects that will increase the likelihood of maximizing the wealth of shareholders (Akbar, 2015).

2.2 Corporate Governance and Financial performance

"To what extent do foreigners invest in poorly governed firms?" a question asked by Christian Leuz, Karl Lins, and Francis Warnock. They conducted a study by examining 4,409 firms in 29 different countries. The purpose of their study was to inspect and understand the factors that directly affect whether external investors will deliver capital to

a nation’s organizations. “They also strive to understand why concerns about corporate governance usually result in decreased foreign holdings” (Leuz & Lins & Warnock, 2008). Poorer external protection, confession, and ownership structures seem to be factors that discourage foreign investment in a country’s firms (Leuz & Lins & Warnock, 2008). Nowadays, what attracts investors, whether overseas or local, is an organization that maintains high standards. High standards refer to firms that manage legal, regulatory, and ethical concerns effectively and efficiently. After all, who wants to invest their money in an organization that will probably burn that cash? A well-governed firm provides a haven for investors. Investors must be able to look at a company and see an organization that is living up to its obligations and embracing a culture that reinforces all securities laws (Leuz & Lins & Warnock, 2008). The findings of this study show that specific factors apply to the chances of foreign holdings investing in country’s firms. First of all, poor corporate governance shows significance about the probability that external investors will invest in such an organization. Weaker and lower governance and transparency hinder and impede overseas investment and financial development (Leuz & Lins & Warnock, 2008). Second, countries where disclosure rules and shareholder protection are weak, tend to create negative relations between internal regulation and foreign holdings. Finally, information asymmetry between foreign and local investors is defined by the assessment of a firm’s governance structure and its chance of expropriation by controlling insiders. Information asymmetry has two major influences. Firstly, opposing selection problems will show when investors transact in foreign markets. The second impact is that when an investment is established, suspect governed mechanisms need special monitoring and management than well-governed firms. Such mechanisms are seen as an expense to foreign investors (Leuz & Lins & Warnock, 2008). This study portrays foreign investors as big corporation funders

who will not hesitate to invest in organizations. However, poor corporate governance may be a considerable deterrent. As governance concerns increase within a firm, the resulting environment will be one of fewer holdings. Unorganized governance structures, which are due to a higher degree of internal control, are perceived as concerns to foreign investors in regards to information and monitoring expenses. For foreigners to invest capital into businesses, organizations must modify certain institutional elements that allow insider control and opaqueness, such as weak property and investor rights (Leuz & Lins & Warnock, 2008).

A study conducted by C. Joe Ueng in 2015 demonstrates the ability that corporate governance has on firm performance (vice versa). The main purpose of Ueng's study was, "to prove a relationship exists between the quality of corporate governance within a firm and financial performance" (Ueng, 2015). 3,068 firms were analyzed, and results have revealed that better corporate governance does, in fact, lead to better financial performance. "Precisely, enhanced board rating, a compensation policy, takeover defense strategy, accounting practice, and a formal governance policy are suggested to increase organizational performance" (Ueng, 2015). The results of this study illustrate and accept the hypothesis which is that the quality of corporate governance structures does, in fact, cause great impact on an organization's financial performance. Also, this research had revealed that when industry-related one-year stock return was used, consistent with the Wald statistic, data demonstrated that board rating and takeover defense had a noteworthy influence on firm performance (Ueng, 2015). In conclusion, there is direct causality that as greater corporate governance structures and mechanisms are implemented throughout an organization, greater financial performance

will result. Likewise, better performing organizations tend to have better governance policies (Ueng, 2015).

2.3 Corporate Governance and Legal Systems

In a study conducted by Leora Klapper and Inessa Love in 2002, research reveals that corporate governance has a high correlation with operating performance and market valuation. What seems to be interesting is the fact that firm-level corporate governance appears to be an issue more in countries with weaker legal systems. This is so because well-governed organizations benefit more in weak corporate governance environments. Also, businesses can somewhat pay off ineffectual laws and enforcement by establishing efficient and adaptable corporate governance alongside giving reliable investor protection (Klapper & Love, 2002). This also proves the fact that for corporate governance to be able to flourish, the country's legal system must be of great priority to policymakers. The results of Klapper and Love reveal that firm-level corporate governance is of greater impact and significance in countries with weaker shareholder protection and poor judicial efficiency. Klapper and Love also illustrate the insufficient legal system and its direct impact on decreasing governance rankings. This leads to the implication that firms cannot completely compensate for the lack of sturdy and enforced laws. The findings of Klapper and Love are related to the theories of Wolfensohn and Shleifer (2002) that state that firms cannot replicate an efficient legal environment independently, but must depend on a judicial system that acts as support. To a certain extent, organizations may be able to enhance their investor protection and minority shareholder rights, however, this strategy cannot replace the absence of a well-formed legal infrastructure (Klapper & Love, 2002).

These results signify the importance of policy implications. Corporate governance on a firm level may seem like a difficult objective to pursue, however, it is a feasible goal. Klapper and Love state that even before judicial and legal reform, firms are still capable of decreasing the cost of capital by implementing certain mechanisms such as credible investor protection provisions.

Another study conducted by Richard Price, Francisco Roman, and Brian Rountree in 2010 states that corporate governance systems are structured to guarantee that investors are granted their justice and fairness when it comes to their return on investment. This makes room for a stronger governance system that will result in an increased allocation of capital. This will immediately instigate growth and will increase the chance an investor has in receiving a return on the money they have invested (Price & Roman & Rountree, 2010). During the 1980s in Mexico, for example, politics and the governmental system played a huge role in business which was the reason for such low corporate governance throughout firms. Later on, during the 1990s, privatization of businesses had begun, and foreign organizations and investors put their money in Mexican firms. Corporate governance now gained great importance to the Mexican government and businesses throughout the country. However, corporate governance was not strictly implemented as Mexico is rated as one of many countries with weak legal systems in regards to the protection of its investor's rights (Price & Roman & Rountree, 2010). Before explaining the hypotheses of this study, it is essential to understand The Code of Best Corporate Practices, which is annually disclosed by firms in Mexico as a measure of the strength of corporate governance mechanisms. This Code is a set of standards and recommendations that enhance corporate governance within firms. The Code sets principles, regulations, and standards that

contribute to the improvement of the board of director's oversight and to disclose clear information to shareholders. The Code aims to achieve four main objectives. 1) Reveal sufficient information in regards to management structure, the board, and their function. 2) Financial information must be transparent, and certain mechanisms must be implied to maintain the establishment of this transparency. 3) Implementation of procedures that enhance effective participation and better interaction between the Board of Directors. 4) Implementation of processes that support sufficient disclosure to shareholders. There are three hypotheses derived from this study. The first suggests that increased compliance with The Code leads to greater performance within an organization. When companies abide by the Code, they are creating a safer environment for investors and other stakeholders by increasing the transparency of their information which narrows the room for fraud (Price & Roman & Rountree, 2010). Second, greater compliance with the Code will result in less organizational earnings management. Earnings management is a technique used by accounting that produces financial reports that shows a positive view of a firm's current financial standing. Compliance with the Code will decrease earnings management because certain new expenses are now present that the firm must deal with. These expenses, however, are minor and short-term. Compliance with the Code will increase corporate governance in the long run and allow investors to view the environment of the organization as safe and transparent. Investors would usually disregard putting their money in hostile environments (Price & Roman & Rountree, 2010). Finally, the third hypothesis states that more compliance with the code will result in a rigid relation between stock market returns and earnings. As Price, Roman, and Rountree state in their findings, this relationship between both greater compliance and a greater relation between stock market return and earnings are merely due to a result in greater confidence in the investor towards the firm.

Organizations willing to implement corporate governance reforms are organizations walking the correct path. However, market monitoring by itself will not sufficiently guarantee considerable reform. What we need is an enhanced understanding of the interaction of law, institutions, finance, and growth before taking any action toward general recommendations about future change (Price & Roman & Rountree, 2010).

In a study conducted by Reena Aggarwal, Isil Erel, Miguel Ferreira, and Pedro Matos in 2009, portfolio holdings of institutions in firms based in 23 countries throughout 2003 to 2008 were examined. The findings suggest that corporate governance is proven to be affected by institutional investment. In fact, the study demonstrates that firm-level governance is positively correlated with international institutional investment. Changes in corporate governance are influenced by changes in institutional ownership by the positive association between the two. However, the opposite does not hold (Aggarwal et al., 2010). This study proves that institutional investment fosters effective corporate governance procedures on a global scale. The study was conducted to observe how institutional investment serves as a means towards enhancing corporate governance across the globe. Institutional investors may impact organizations to implement better governance measures, both directly and indirectly. Causing changes in management and using voting rights is a direct effect of the institutional investment on corporate governance (Aggarwal et al., 2010). On the other hand, institutional investors effect the corporate governance of organizations indirectly by making decisions such as buying shares or threatening to sell the organization's shares (2nd par). Striking events have taken place with regards to foreign shareholders and the significant roles they play in corporate governance outcomes.

2.4 The Effect of the Legal System on Corporate Governance and Financial Development

A research study conducted by Kevin C.W. Chen, Zhihong Chen, and K.C. John Wei attempts to understand the effect of firm-level corporate governance on capital, and if country-level legal protection of investors may have an influencing effect on such a relationship. The reason of this study is to demonstrate that corporate governance seems to have a negative effect on the cost of capital, especially when the organization is located in a country that has poor legal protection (Chen & Chen & Wei, 2009). There are two issues concerning this matter.

The first matter is that of the quality of corporate governance. This quality reduces the cost of equity in markets where there is a relatively poor legal protection of investors. Why is corporate governance so important? Well, corporate governance is a mechanism that ensures shareholder protection against expropriation by managers and other dominant shareholders. The Agency Theory states there exists a conflict of interest, or struggle, between managers and the shareholders. Corporate governance does, in fact, reduce agency costs (Chen & Chen & Wei, 2009). However, the relation between corporate governance and legal protection remains unclear. “It may be that the valuation effect reveals different levels of expropriation and investment opportunities, such as the cash flow effect. Also, effective corporate governance, or legal protection, decrease the risk premium that investors demand. This results in a reduced cost of capital also referred to as the discount rate effect” (Chen & Chen & Wei, 2009)..

“A second issue illustrates the influence of national law protection on investors on the relation between firm-level corporate governance and cost of equity” (Chen & Chen &

Wei, 2009). Certain studies and surveys have concluded that firms with legitimate corporate governance attract institutional investors that are willing to pay a higher premium for shares. This proves the beneficial and positive impact corporate governance structures and mechanisms have on a firm. To emphasize, "institutional investors are willing to pay a higher premium for shares in organizations that foster corporate governance, especially when these businesses are located in countries that have a weak legal protection of investors" (Chen & Chen & Wei, 2009).

So, the advantages of having a corporate governance mechanism are more reflective in markets where there is a weak enforcement investor protection. This demonstrates the fact that "country-level legal protection of investors' substitutes firm-level corporate governance" (Chen & Chen & Wei, 2009).

In conclusion, businesses in countries where the legal system doesn't carry out high cost of expropriation will give larger value to corporate governance. However, at a business level, corporate governance is of less worth when it comes to reducing the cost of equity in countries where legal protection of investors is strong (Chen & Chen & Wei, 2009).

2.5 Corporate Governance in Lebanon

The notion of corporate governance has recently come on the scene in Lebanon. The country's legal issues, along with the gradual process it takes to implement, have hindered corporate governance practices in the country. The implementation of proper corporate governance remains an issue due to the predominance of businesses that are run the traditional Lebanese way, and due to the legal issues that arise from the nation's poor regulatory system. With regards to the first issue, many firms run by families form the Lebanese economy. Thus they tend to manage their businesses using their philosophies, rather than implementing renowned business practices and measures. Research shows that

Lebanese family businesses are reluctant to appoint an independent person on their board in fear of compromising sensitive data and assigning decision-making discretion to outsiders. Thus, proper corporate governance practices are not applied due to these reasons. There is also no governmental bodies that devise and ensure the implementation of corporate governance practices, further preventing the application of proper corporate governance in Lebanon.

Nonetheless, there exist some regulatory entities that impose corporate governance policies. One example is the Lebanese Central Bank. Given its authority to regulate the banking and financial sectors, it possesses the right to make corporate governance policies which banks are then mandated to abide by. The Banking Control Commission (BCC) supervises banks and financial institutions' conformity to the governance policies that the Lebanese Central Bank establishes, and the Lebanese Central Bank can then issue punitive measures on the banks or financial institutions if they fail to abide by them. The Lebanese Code of Commerce (LCC) includes multiple provisions concerning shareholder powers during the ordinary general assembly, such as, "appointment and removal of Board members and auditors, prior approval of transactions between the company and its directors, determination of the remuneration of its directors and auditors, repurchase by the company of its own shares, and issuance of its own bonds" (Meouchi & Meouchi, 2017).. It also includes provisions regarding voting rights. For example, article 110 of the LCC puts the general guideline according to which all shareholders must have similar privileges and enjoy the same benefits. It also includes provisions about shareholders meetings and holdings. However, it does not provide for the capability of shareholders to neither act by written consent without a meeting, nor to hold virtual meetings of shareholders. A one-tier structure has been implemented by the LCC, in addition to a Board of Directors that is

selected by the Ordinary General Assembly (OGA). One member of the Board of Directors is fixed as Chairman, however, under the provision of the LCC, the roles of Chairman and General Manager are mutual. Furthermore, it does not provide for a requirement of the least amount of non-executive or independent directors mandatory (Meouchi & Meouchi, 2017).

Article 166 of the LCC states that "directors are liable, even with regards to 3rd parties, for their fraudulent acts and breaches of the law and company bylaws. Also, article 167 of the LCC provides, in its first paragraph, that directors are liable towards shareholders for their errors of management" (Meouchi & Meouchi, 2017). It doesn't discriminate between the roles of separate members of the board and does not call for mandatory board committees although article 153 provides that the chairman may assign a consultative committee comprised of members of the board or in some cases they may be managers from outside the board. The LCC does not regulate the issue of indemnification of directors and officers in respect to liabilities incurred in their professional capacity (Meouchi & Meouchi, 2017). Also, it does not regulate board and director evaluations, and employees in Lebanon have no contribution in playing a role in corporate governance. The Decision of the Central Bank of Lebanon (BDL) No. 7,737 of December 15, 2000, relates to internal control and auditing within banks and other financial organizations. This decision provides that upper management must establish a structure for the bank's internal control that must be updated as required (Meouchi & Meouchi, 2017). Also, it sets the standards to which this framework must excel at and provides that all financial organizations must have an internal audit unit that has to meet the requirements of this decision. The president of this unit is selected by the Board, and their information (name and CV) is given to the BCC.

The functions of this unit include evaluation of corporate governance and its policies and procedures, compliance of departments and branches, verification of the effectiveness of the process, and compliance with procedures of laws and regulations (Meouchi & Meouchi, 2017). Other sources of law for corporate governance in Lebanon include:

- BDL Circular No. 9,382 of July 26, 2006, concerns corporate governance in banks stating that they must conform to the principles of the Basel Committee, formulate their Code of Corporate Governance that must be available on their website and annual report, and provide the BCC with a soft and hard copy of the Code.
- BDL Circular No. 9,956 of July 21, 2008, relates to the Board of Directors of Lebanese Banks and their committees. The roles and functions of non-executive members are also set out.
- BDL Circular No. 10,224 of August 13, 2009, provides procedures for the appointment and selection of auditors.
- BDL Circular No. 11,323 of January 12, 2013, suggests the formation of a compliance department that focuses on the composition, functioning, duties, and prerogatives of the compliance department.
- BDL Circular No. 11,821 of August 6, 2014, focuses on remunerations and bonuses granted to employees.
- BDL Circular No. 11,947 of February 12, 2015, relates to the banking and financial, operational principles that must be considered when dealing with clients.

The Code of Money and Credit (CMC) suggests that the general assembly must approve of any letters of credit fixed to board members and that any shareholder that owns at least 10 percent of

the shareholding of the organization is eligible to file before the proficient courts an opposition to the appointment of an auditor by the general assembly (Meouchi & Meouchi, 2017).

The Lebanese Transparency Association (LTA) and the Lebanese Corporate Governance Task Force (LCGTF) launched a code together that they named the Lebanese Code of Corporate Governance for Small and Medium-Sized Enterprises (LCCG) that is formulated around the Organization of Economic Cooperation and Development(OECD) standards (Meouchi & Meouchi, 2017). It relates to the (Meouchi & Meouchi, 2017:

- rights of shareholders and key ownership roles;
- shareholders' rights about shareholders' meetings;
- equality of shareholder treatment;
- protection of minority shareholders in board composition;
- board structure, membership, and function;
- fiduciary duties of board members;
- monitoring of board functions and accountability to shareholders;
- determination and disclosure of the remuneration of the board of directors;
- board and the role of stakeholders;
- internal audit;
- external independent auditors

Despite the efforts of the LCGTF in drafting a report about doing amendments to the LCC to enhance corporate governance in Lebanon, no reply has been given although the issue had been discussed by a parliamentary committee (Meouchi & Meouchi, 2017). Unfortunately, no

governmental agencies or entities that implement corporate governance policies exist within Lebanon. However, certain regulatory authorities provide such policies. The BDL, for example, being a regulator in the banking and financial sectors, can render certain laws regarding corporate governance that banks, financial institutions, and some companies are forced to implement (Meouchi & Meouchi, 2017). Moreover, if the competent commercial registry detects any event of non-compliance, it may reject registration. If the law were to provide corporate governance principles, these principles would be used within the courts of law.

2.6 Corporate Governance in MENA Region

Similar to corporate governance in Lebanon, corporate governance in the MENA region faces the same issue. Family-owned, small-sized, and medium-sized businesses constitute the vast majority of the economy. In this regard, they face the same issues as Lebanon. Another factor impinging upon corporate governance in the MENA region is the prevalence of state-owned enterprises. They are responsible for production, consumption and labor markets in various economies, resulting in an economic landscape with a "dualistic" aspect.

For instance, Lebanon would highly benefit from the implementation of corporate governance practices. It would help abolish the ongoing corruption and waste that has plagued the country, along with the poor governance that has led to many scandals throughout the years, such as those in Al Ahli Bank and Mebco. Corporate governance in Lebanon at the national level would serve as a great means towards achieving economic growth and efficiency by combating the vices above of the nation. Thus, corporate governance in Lebanon is crucial to its economy, but the difficulty is whether the country

can implement international corporate governance principles which would allow it to make amendments to its legal structure to lay the foundation for proper and effective corporate governance.

Chapter Three
Hypothesis Development

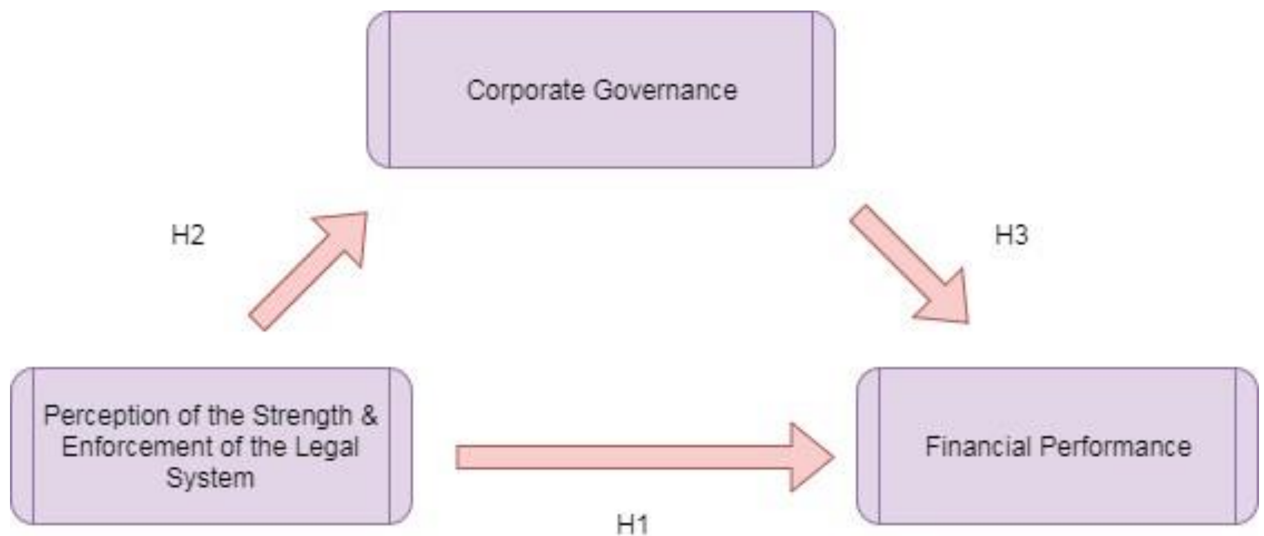
H1: The perception of the strength & enforcement of the legal system has a positive influence on Financial Performance.

H2: The perception of the strength & enforcement of the legal system has a positive influence on Corporate Governance.

H3: Corporate Governance has a positive influence on Financial Performance.

Thus, these three hypotheses (H_1), (H_2) and (H_3) add up to formulate the fourth hypothesis:

H4: Corporate Governance mediates the relationship between the perception of the strength & enforcement of the Legal System and Financial Performance.



Chapter Four

Methodology

The objective of this research is to observe the level of corporate performance at SMEs in Lebanon, to examine the managers' and employees' perception regarding the application of proper corporate governance mechanisms within these firms, and to detect the effect of the perceived enforcement and strength of the legal system on the proper implementation of corporate governance mechanisms and financial performance. Studying these three variables is set out to examine the total mediating role that corporate governance plays in the relation between perceived strength of the legal system and performance at the level of Lebanese SMEs.

4.1 Research Design

The nature of the research design is a quantitative measure because a questionnaire was administered to participants, and also due to the numerical measure of the data collected which was later analyzed.

A cross-sectional analysis is referred to in this study since there had been a one-time contact with the participants when the data was collected.

4.2 Sample and Questionnaire

The questionnaires distributed were self-administered and carried out in person, and were composed of four main sets of questions. The complete questionnaire can be referred to in Appendix A.

The first section involved fourteen questions measuring demographics which include but are not limited to the size of the firm, board of directors' size, number of board meetings annually,

annual sales revenue, participants' years of experience, age, gender, attendance of family members to board meetings, and participation of family members in board decisions. This section followed the Choice Determinant Structure.

The Likert 5 point Scale method (ranging from Strongly Disagree SD to Strongly Agree SA) has been used in the second set of questions aiming to determine the relation between Corporate Governance and transparency of financial data, ownership structures and control privileges, the structure of the board of directors and management, and the auditing committee in the company. Refer to Tables 1,2,3, and 4.

The same method of Likert 5 point scale was also used in the third set of questions aiming to ask the participants about the financial performance of the company in which they work in, specifically with regards to growth in sales, market share, number of employees and profitability, also regarding profit margin on sales and the ability to fund growth from profits. Another table was structured to compare current performance of the company to past performance. Refer to Tables 5 and 6.

The fourth set of questions also used the Likert 5 method to determine the strength of the legal system in the participants' country and how well it is implemented. Also, it aims to demonstrate the effect of the local legal system on imposing corporate governance policies, protecting foreign investments and ensuring rights of minority shareholders. The last two questions intended to measure the impact of international acts and policies on the implementation of rules within the company and on creating good corporate governance policies. Refer to Table 7.

The questionnaire targeted 90 participants arbitrarily, including managers and employees working within small to medium and large enterprises in Lebanon, and only 58 of the questionnaires were completed; 54 of the 58 were fully completed.

Table 1: Corporate Governance and Transparency of Financial Data

CGTRN	1	2	3	4	5
1- Financial Results					
2- Objectives of the company					
3- Accounting evaluations					
4- Related party transactions: elements and nature					
5- Related party transactions: practices and disclosure (under control)					
6- Board's duties and financial communications					
7- Extraordinary transactions regulations					
8- Alternative accounting decisions: impact and analysis					
9- The process for decision making and approval of transactions with related parties					

Table 2: Corporate Governance and Ownership Structures and Control Privileges

CGOWN	1	2	3	4	5
1- Structure of ownership					
2- Control organization					
3- Control and equity stake					
4- Control privileges					
5- Existence of meeting agenda					
6- Procedures for holding annual meetings					
7- Shareholders diversity					
8- Actions for anti-takeovers					
9- Regulations that cover and guide the corporate control					

Table 3: Corporate Governance and Structure of Board of Directors and Management

CGBRD	1	2	3	4	5
1- Structures and goals of risk management					
2- Board of director's structure: non-executives vs executive					
3- Information about board members such as qualifications and biographical information					
4- Responsibilities and positions of outside board members					
5- Position held by the executives and the member of outside board members					
6- Checks and balances instruments					
7- Presence of a succession plan					
8- Conflict of interest prevention through committees and governance procedures					
9- Governance committee composition and main task					
10- Board of directors: function and role					
11- Length of contract for directors					
12- Composition of the remuneration of directors and its determinants					
13- Number of independent board members					
14- Professional activities for training and development					
15- Reimbursement plan for senior managers in special cases such as merger and acquisition					
16- Presence of procedures covering conflicts of interest among board members					
17- Existence of advisors during reporting period					
18- Process for evaluating performance					
19- Management and board members' material interests					

Table 4: Corporate Governance and Auditing

CGADT	1	2	3	4	5
1- Procedures governing collaboration with external auditors					
2- Procedures and responsibilities for appointing internal auditors					
3- Reliability of external auditors and board's confidence					
4- Procedures governing collaboration with internal auditors					
5- Decision making procedure for appointing external auditors					
6- Internal control systems					
7- Period of auditor contracts					
8- Audit partner rotation process					
9- The remuneration of auditors and involvement in non-audit work					

Table 5: Performance level in Company

CFPCP	1	2	3	4	5
1- Growth in sales					
2- Growth in market share					
3- Growth in employees					
4- Growth in profitability					
5- Profit margin on sales					
6- The ability to fund growth from profits					

Table 6: Current Performance level in Company compared to Past Performance

CFPCHGP	Much Worse	Worse	About the Same	Slightly Higher	Higher
1- Growth in sales					
2- Growth in market share					
3- Growth in employees					
4- Growth in profitability					
5- Profit margin on sales					
6- The ability to fund growth from profits					

Table 7: Strength of the Legal System

		1	2	3	4	5
SLS1	The legal system in your country ensures a strict implementation of legal rules and regulations					
SLS2	The legal system in your country enforces diversity (age, gender, professional background, etc..) within the company					
SLS3	The legal system in your country enforces diversity (age, gender, professional background, etc..) within the board of directors					
SLS4	The legal system in your country creates a strong internal corporate bylaws and policies within the company					
SLS5	The legal system in your country creates a strong internal corporate code of conduct					
SLS6	You are aware of the existence of legal rules that impose corporate governance policy.					
SLS7	The legal system provides the necessary protection for foreign investments in the company.					
SLS8	The legal system ensures strong law enforcement for protection of minority shareholders.					
SLS9	International acts and policies affect the creation and implementation of rules and regulations within the company					
SLS10	International acts and policies have a direct effect on corporate governance policies within the firm					

4.3 Instrumentation

The software program SPSS is adopted to test the previously developed hypotheses and the statistical techniques which are used included the following:

- Descriptive statistics
- Factor analysis for the two main parts of the questionnaire: corporate governance and financial performance.
- Correlation and Mediation analysis

Chapter Five

Statistical Findings

This division shows the statistical results of the questionnaire and covers the following sections: demographics, measurement model, score, factor analysis and the structural model.

5.1 Demographics

The majority of the respondents (55.2%) reported working in a small enterprise while the remaining (44.8%) reported working in a medium or large firm.

Table 8: Size of firm

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Small	32	53.3	55.2	55.2
	Medium/Large	26	43.3	44.8	100.0
	Total	58	96.7	100.0	
Missing	System	2	3.3		
Total		60	100.0		

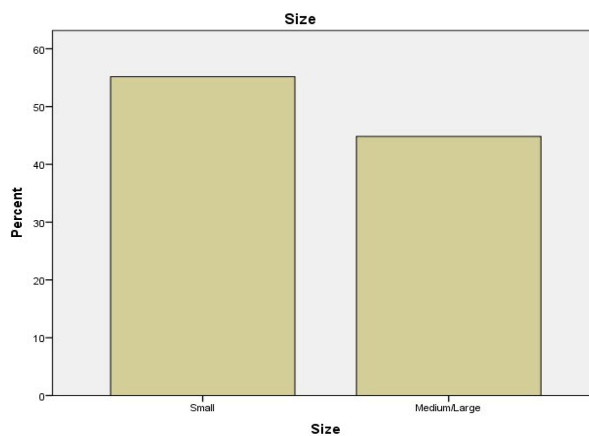


Figure 1: Size of the firm

Regarding sales, the majority of respondents 32.8% stated that the annual sales of the company in which they work are between $100,000 and $499,000, whereas 29.3% stated that the annual sales had exceeded $1,000,000 and 19% has stated that sales were between $500,000 and $1,000,000 per year and 17.2% stated that annual sales were less than $100,000.

Table 9: Annual Sales

Sales

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid					
	< 100,000 $	10	16.7	17.2	19.0
	100,000 - 499,000 $	19	31.7	32.8	51.7
	500,000 - 1,000,000 $	11	18.3	19.0	70.7
	> 1,000,000 $	17	28.3	29.3	100.0
	Total	58	96.7	100.0	

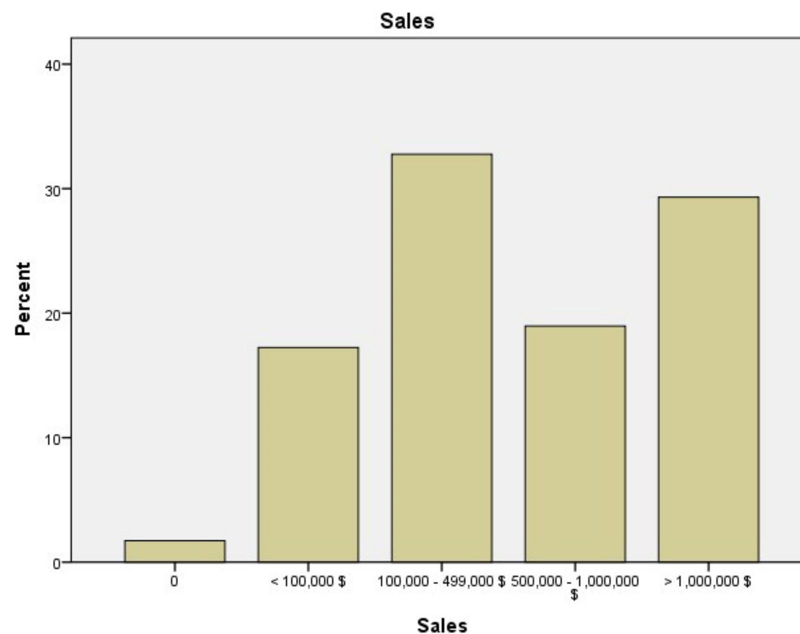


Figure 2: Annual Sales

As shows in Table 10, the majority of participants (41.4%) stated that there was a slight increase in sales changes while the minority (12.1%) either said there was a slight decrease or no change at all. This shows a slight annual increase in implementing beneficial outcomes.

Table 10: Change Sales

Change Sales

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Decreased significantly	7	11.7	12.1	12.1
	Decreased slightly	10	16.7	17.2	29.3
	No change	7	11.7	12.1	41.4
	Increased slightly	24	40.0	41.4	82.8
	Increased significantly	10	16.7	17.2	100.0
	Total	58	96.7	100.0	
Missing	System	2	3.3		
Total		60	100.0		

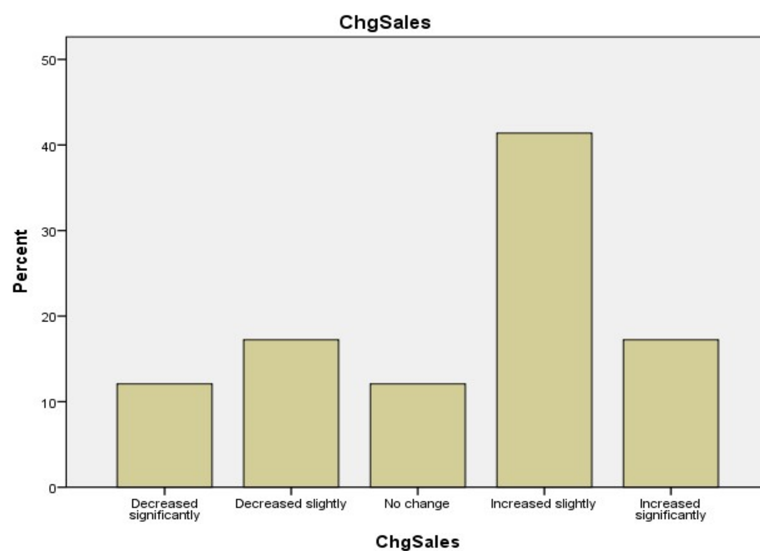


Figure 3: Change Sales

The experience of the participants in our study, based on statistical findings, reveals that most respondents (44.8%) have had less than 5 years of experience, 32.8% have had 5 10 years of experience, and the remainder (22.4%) have had more than 10 years of experience.

Table 11: Experience of Participants

Exprience

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	< 5 years	26	43.3	44.8	44.8
	5-10 years	19	31.7	32.8	77.6
	> 10 years	13	21.7	22.4	100.0
	Total	58	96.7	100.0	
Missing	System	2	3.3		
Total		60	100.0		

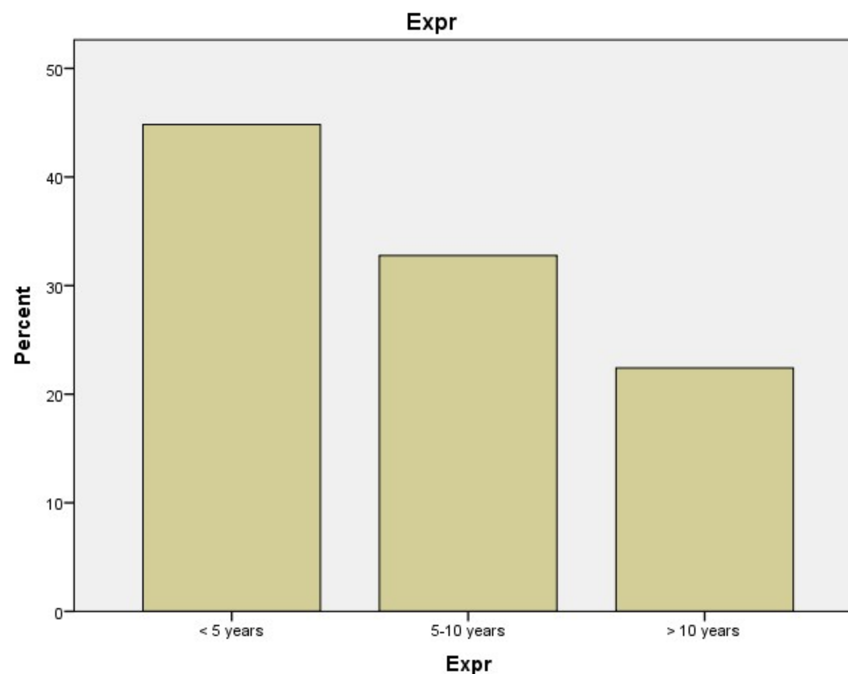


Figure 4: Experience of Participants

Participants who filled in the surveys, were mostly (72.4%) below the age of 30, 20.7% were between the age of 30-40, and the lowest group (6.9%) were above the age of 40.

Table 12: Age of Participants

Age

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	< 30 years	42	70.0	72.4	72.4
	30-40 years	12	20.0	20.7	93.1
	> 40 years	4	6.7	6.9	100.0
	Total	58	96.7	100.0	
Missing	System	2	3.3		
Total		60	100.0		

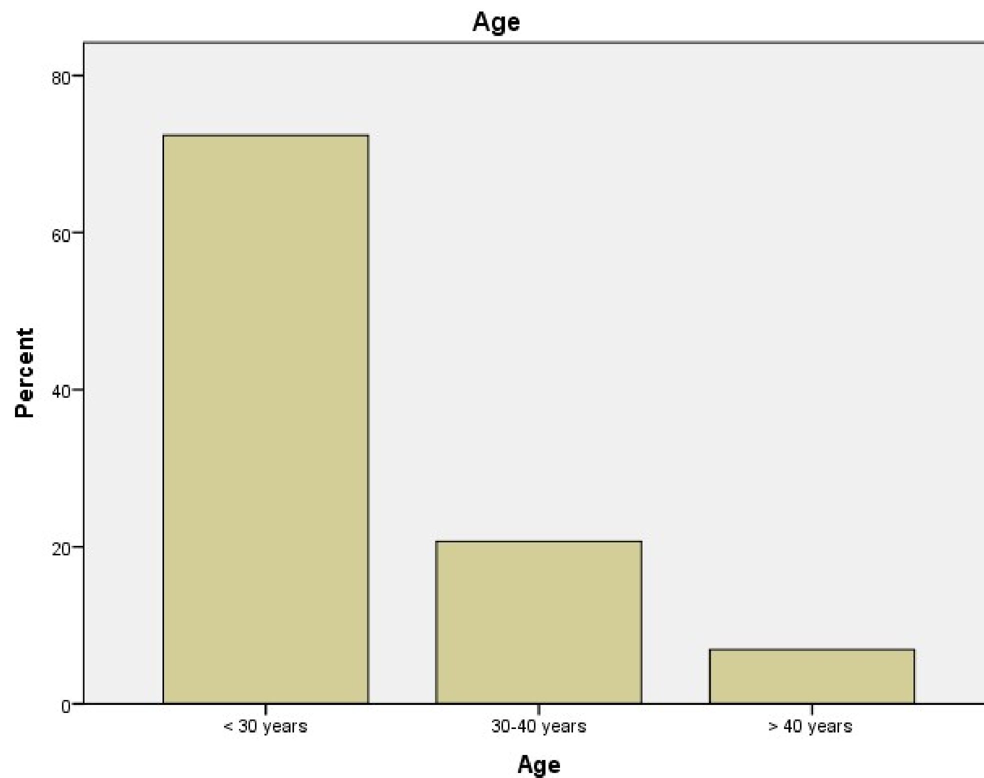


Figure 5: Age of Participants

The majority of participants (58.1%) stated that family members who are not part of the legal board members do not attend board meetings, while 23.3% stated that those family members do attend the meetings. The remainder (18.6%) left the question unanswered.

Table 13: Family Members

Family Members

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0	8	13.3	18.6	18.6
	Yes	10	16.7	23.3	41.9
	No	25	41.7	58.1	100.0
	Total	43	71.7	100.0	
Missing	System	17	28.3		
Total		60	100.0		

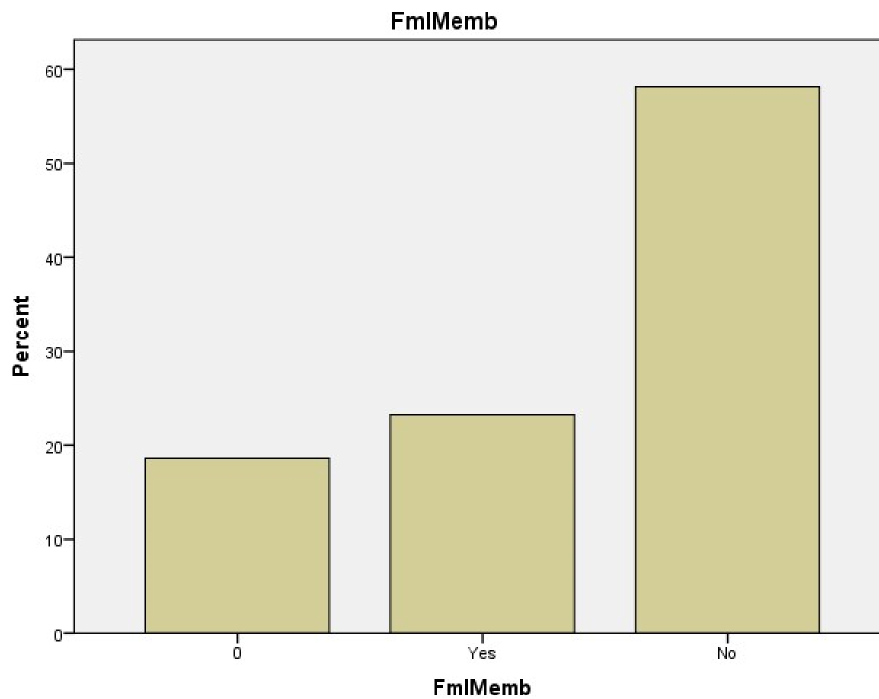


Figure 6: Family Members

The majority of participants (34.9%) stated that family members never engage and participate in board decisions, another group (32.6%) stated that family members sometimes engage and participate in decisions, and the minority (16.3%) stated that they always do.

Table 14: Decision Making

Decision

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0	7	11.7	16.3	16.3
	Always	7	11.7	16.3	32.6
	Sometimes	14	23.3	32.6	65.1
	Never	15	25.0	34.9	100.0
	Total	43	71.7	100.0	
Missing	System	17	28.3		
Total		60	100.0		

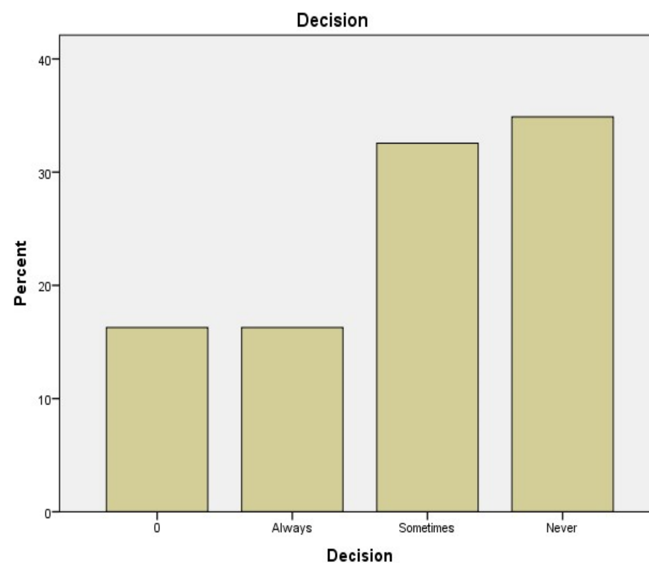


Figure 7: Decision Making

The majority of participants (42.1%) revealed that long and short term debt was 1-25% of equity while the minority (8.8%) said it was 50% of equity.

Table 15: Debt to Equity Ratio

Debt to Equity Ratio

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	0	3	5.0	5.3	5.3
	1%-25%	24	40.0	42.1	47.4
	26%-50%	23	38.3	40.4	87.7
	50%-	5	8.3	8.8	96.5
	4	2	3.3	3.5	100.0
	Total	57	95.0	100.0	
Missing	System	3	5.0		
Total		60	100.0		

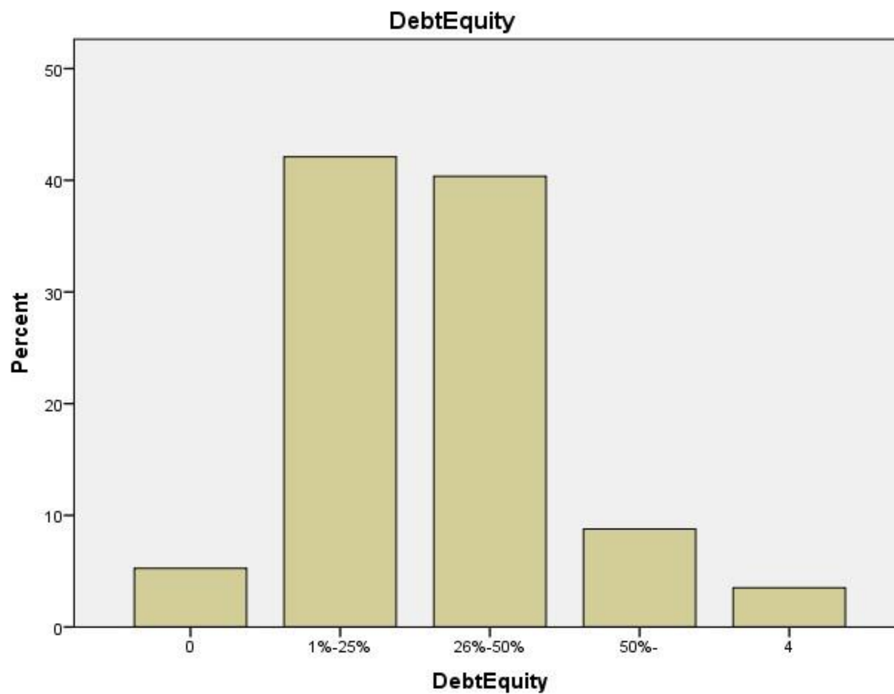


Figure 8: Debt to Equity Ratio

Participants were mostly female (67.2%) and the remaining (32.8%) were male participants.

Table 16: Gender

Gender

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Male	19	31.7	32.8	32.8
	Female	39	65.0	67.2	100.0
	Total	58	96.7	100.0	
Missing	System	2	3.3		
Total		60	100.0		

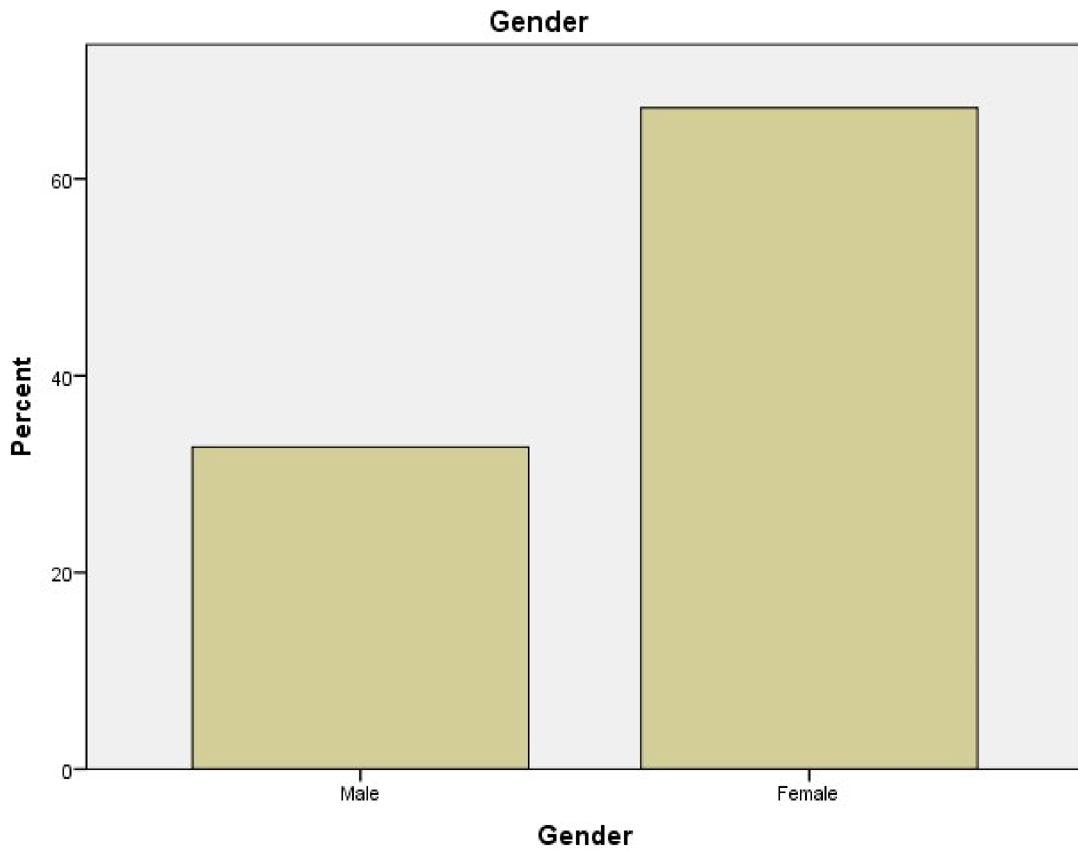


Figure 9: Gender

Most respondents (44.8%) stated that the Board size within their organizations were made up of 1-4 members, while the least amount of respondents (19%) stated that the Board size was greater than 10 members.

Table 17: Board Size

BoardSize

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1 - 4 members	26	43.3	44.8	44.8
	5 - 10 members	21	35.0	36.2	81.0
	> 10 members	11	18.3	19.0	100.0
	Total	58	96.7	100.0	
Missing	System	2	3.3		
Total		60	100.0		

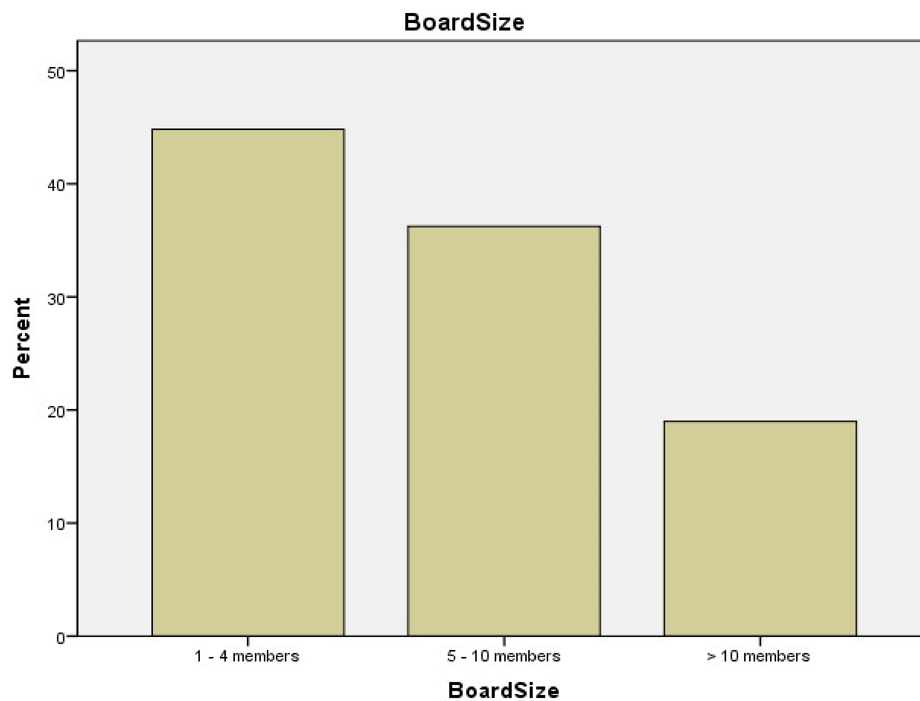


Figure 10: Board Size

As most participants stated (37.9%), board meetings were conducted 1-3 times annually, 36.2% claimed that board meetings were conducted more than 6 times annually, and the least amount of participants (25.9%) stated that board meetings were conducted 4-6 times annually.

Table 18: Annual Board Meetings

BoardMeet

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	1 - 3 times	22	36.7	37.9	37.9
	4 - 6 times	15	25.0	25.9	63.8
	> 6 times	21	35.0	36.2	100.0
	Total	58	96.7	100.0	
Missing	System	2	3.3		
Total		60	100.0		

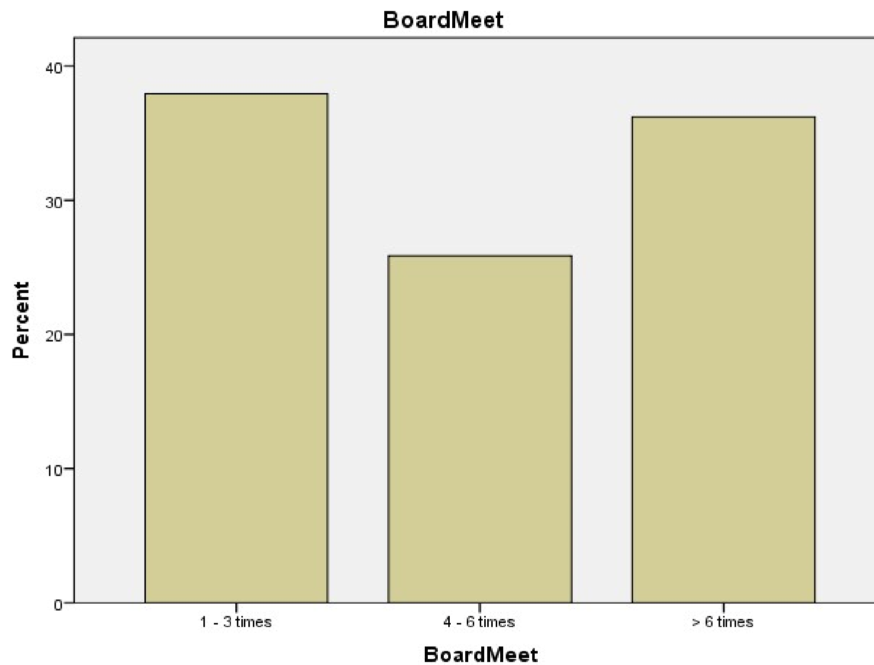


Figure 11: Annual Board Meetings

5.2 The Measurement Model

A reliability analysis was conducted on the seven major variables of this study which are:

1. Corporate governance and transparency of financial data
2. Corporate Governance and Ownership Structures and Control Privileges
3. Corporate Governance and Structure of Board of Directors and Management
4. Corporate Governance and Auditing
5. Performance level in Company
6. Current Performance level in Company compared to Past Performance
7. Perception of the Strength of the Legal System

The reliability results in Table 19 reveal a Cronbach's alpha value >0.7. Since the results correlate greater than 0.7, this indicates that the questionnaire holds high reliability. Thus, further analysis is conductible.

Table 19: Reliability

Construct	Cronbach's Alpha	Number of items
CGTRN	.951	9
CGOWN	.868	9
CGBRD	.957	19
CGADT	.769	9
CFPCP	.871	6
CFPCHGP	.955	6
SLS	.937	10

5.3 Score

For each dimension of corporate governance, a score was calculated based on averaging. These scores are denoted by CGTRNS, CGOWNS, CGBRDS, and CGADTS.

In addition, an overall performance score (CFPCPS) and a change in performance (CFPCHGPS) were calculated.

Finally, a score for the strength of the legal system (SLSS) was also calculated. These scores will be used to test the above-mentioned hypotheses.

5.4 Factor Analysis Scores

Confirmatory factor analysis was conducted using the items from the dimensions of corporate governance as well as the strength of the legal system and the performance constructs. In each case a score was calculated based on averaging. The resulting scores of the corporate governance components are denoted by CGTRNS, CGOWNS, CGBRDS, and CGADTS. Table 20 lists the component matrices for each dimension of CG. In each case, all loading factors were above 0.7. The parceling method was then used on the components scores to obtain an overall corporate governance score denoted by CGS.

Table 20: Component Matrices for Components of CG

TRN		OWN		BRD			ADT	
CGTRN1	0.779	CGOWN1	0.84	CGBRD1	0.839		CGADT1	0.774
CGTRN2	0.848	CGOWN2	0.867	CGBRD2	0.878		CGADT2	0.886
CGTRN3	0.944	CGOWN3	0.908	CGBRD3	0.777		CGADT3	0.868
CGTRN4	0.828	CGOWN4	0.821	CGBRD6	0.756		CGADT4	0.896
CGTRN5	0.847	CGOWN5	0.75	CGBRD10	0.812		CGADT5	0.88
CGTRN6	0.819	CGOWN6	0.84	CGBRD17	0.719		CGADT6	0.876
CGTRN7	0.847	CGOWN7	0.847	CGBRD12		0.885	CGADT7	0.821
CGTRN8	0.864	CGOWN8	0.767	CGBRD13		0.866	CGADT8	0.781
CGTRN9	0.856	CGOWN9	0.827	CGBRD15		0.777	CGADT9	0.84
				CGBRD16		0.885		

Component Matrix: Extraction Method: Principal Component Analysis

In addition, an overall performance score (CFPCPS) and a change in performance score (CFPCHGPS) were calculated. Finally, a score for each of the three components of the strength of the legal system: enforcement, awareness, and international acts, was calculated through factor analysis using the regression method. The three scores are labeled LSS1, LSS2, and LSS2. Also, an overall score LSS was obtained through the parceling method. These scores will be used to test the above mentioned hypotheses.

5.5 Correlation Analysis

Using the CG scores, the correlation matrix was calculated to examine their relationships with performance. Table 21 shows these correlations along with their significance.

Table 21: Correlations Matrix (CG and Performance)

		TRNS	OWNS	BRDS	ADTS	CGS
PRFS	Pearson Correlation	.093	.137	.031	.149	.114
	Sig. (1-tailed)	.251	.161	.411	.142	.205
	N	54	54	54	54	54
CPRMS	Pearson Correlation	.197	.233*	.107	.078	.171
	Sig. (1-tailed)	.077	.045	.222	.286	.109
	N	54	54	54	54	54

The results in Table 21 indicate that the ownership component of CG has a significant positive relation with the change of performance, while transparency components have a marginal positive relationship with the change in performance. None of the components of CG were found to have a significant relationship with performance. Hence, companies cannot benefit momentarily from CG. The benefits are attained overtime through good governance practices in terms of the ownership and transparence components of CG.

The next step in the correlation analysis is to examine the relationships between CG and its components with the perceived strength of the legal system through its three components: enforcement, awareness, and international acts. The results are listed in Table 22.

Table 22: Correlations

		TRNS	OWNS	BRDS	ADTS	CGS
LSS1	Pearson Correlation	.478**	.618**	.387**	.473**	.542**
	Sig. (1-tailed)	.000	.000	.002	.000	.000
	N	54	54	54	54	54
LSS2	Pearson Correlation	.430**	.616**	.427**	.371**	.510**
	Sig. (1-tailed)	.001	.000	.001	.003	.000
	N	54	54	54	54	54
LSS3	Pearson Correlation	.333**	.497**	.391**	.407**	.450**
	Sig. (1-tailed)	.007	.000	.002	.001	.000
	N	54	54	54	54	54
LSS	Pearson Correlation	.458**	.640**	.446**	.460**	.554**
	Sig. (1-tailed)	.000	.000	.000	.000	.000
	N	54	54	54	54	54

The results in Table 22 indicate that all relationships are highly significant. The strongest relationships are between the ownership component of CG and the awareness and perceived enforcement of the legal system. Accordingly, when companies are aware of the legal system with the perception that it is being enforced and provides protection to

minority shareholders and foreign investors, they tend to have higher corporate governance practices.

The final step in the correlation is to consider the relationships between the perceived strength of the legal system and corporate performance. The results are shown in Table 23 below.

Table 23: Correlations

		LSS1	LSS2	LSS3	LSS
PRFS	Pearson Correlation	.367**	.192	.183	.272*
	Sig. (1-tailed)	.003	.082	.093	.023
	N	54	54	54	54
CPRMS	Pearson Correlation	.417**	.392**	.295*	.408**
	Sig. (1-tailed)	.001	.002	.015	.001
	N	54	54	54	54

The results revealed that awareness, perceived enforcement, and international acts, as well as the overall perception of the strength of the legal system, have significant positive relationship with change in performance. Hence, such perception and awareness of the strength of the legal system lead to better performance overtime. However, only the perception of the enforcement of the legal system may be associated with momentarily benefits in performance as the correlation analysis shows a significant positive relationship between enforcement and current performance.

5.6 Mediation Analysis

The result of the correlation analysis suggests that the awareness and perception of the strength of the legal system may lead to better performance overtime. However, such benefits attained directly from the awareness and perception of the strength of the legal system has to be through better corporate governance practices, which is precisely the statement of hypothesis H4. To test hypothesis H1-H4, mediation analysis was conducted using Hayes' process macro in SPSS. The results depicted in Table 24 provide evidence supporting H1 indicating that the ownership component of corporate governance fully mediates the relationship between the perception of the enforcement of the legal system and change in performance. Hence, the perception of the enforcement of the legal system leads to better performance overtime through better corporate governance practices especially in terms of the ownership components.

The analysis was repeated for the overall perception of the strength of the legal system resulting in similar findings.

Table 24: Mediation Analysis (Perception of enforcement, CG and Change in Performance)

```
Run MATRIX procedure:

************* PROCESS Procedure for SPSS Release 2.16.3 ******************
          Written by Andrew F. Hayes, Ph.D.       www.afhayes.com
    Documentation available in Hayes (2013). www.guilford.com/p/hayes3
**************************************************************************
Model = 4
    Y = CPRMS
    X = OWNS
    M = LSS1

Sample size
         54

**************************************************************************
Outcome: LSS1

Model Summary
          R       R-sq        MSE          F        df1        df2          p
 .6179      .3818      .6301    32.1112     1.0000    52.0000      .0000  Model
              coeff         se          t          p       LLCI       ULCI
constant      .0000      .1080      .0000     1.0000     -.2168      .2168
OWNS          .6179      .1090     5.6667      .0000      .3991      .8367

**************************************************************************
Outcome: CPRMS

Model Summary
          R        R-sq         MSE           F        df1         df2           p
 .4180      .1748      .8576     5.3999     2.0000    51.0000      .0075
 Model
              coeff         se          t          p       LLCI       ULCI
constant      .0000      .1260      .0000     1.0000     -.2530      .2530
LSS1          .4415      .1618     2.7287      .0087      .1167      .7662
OWNS         -.0398      .1618     -.2460      .8067     -.3646      .2850

******************** DIRECT AND INDIRECT EFFECTS ************************
Direct effect of X on Y
     Effect         SE          t          p       LLCI       ULCI      -
.0398      .1618     -.2460      .8067     -.3646      .2850

Indirect effect of X on Y
         Effect    Boot SE   BootLLCI   BootULCI
LSS1      .2728      .1227      .0975      .6247
******************** ANALYSIS NOTES AND WARNINGS ************************
Number of bootstrap samples for bias corrected bootstrap confidence intervals:
5000

Level of confidence for all confidence intervals in output:
95.00

------ END MATRIX -----
```

Table 25: Mediation Analysis (Strength of the legal system, CG and Change in Performance)

```
Run MATRIX procedure:

************* PROCESS Procedure for SPSS Release 2.16.3 *****************

          Written by Andrew F. Hayes, Ph.D.       www.afhayes.com
    Documentation available in Hayes (2013). www.guilford.com/p/hayes3
**************************************************************************
Model = 4
    Y = CPRMS
    X = OWNS
    M = LSS

Sample size
         54

**************************************************************************
Outcome: LSS

Model Summary
          R       R-sq        MSE          F        df1        df2          p
.6396      .4091      .6023    35.9962     1.0000    52.0000      .0000
Model
              coeff         se          t          p       LLCI       ULCI
constant      .0000      .1056      .0000     1.0000     -.2119      .2119
OWNS          .6396      .1066     5.9997      .0000      .4257      .8535

**************************************************************************
Outcome: CPRMS

Model Summary
          R       R-sq        MSE          F        df1        df2          p
.4094      .1676      .8650     5.1342     2.0000    51.0000      .0093
Model
              coeff         se          t          p       LLCI       ULCI
constant      .0000      .1266      .0000     1.0000     -.2541      .2541
LSS           .4379      .1662     2.6350      .0111      .1043      .7716
OWNS         -.0471      .1662     -.2835      .7779     -.3808      .2865

******************** DIRECT AND INDIRECT EFFECTS ************************

Direct effect of X on Y
     Effect         SE          t          p       LLCI       ULCI      -
.0471      .1662     -.2835      .7779     -.3808      .2865

Indirect effect of X on Y
        Effect    Boot SE   BootLLCI   BootULCI
LSS      .2801      .1173      .1092      .6489

******************** ANALYSIS NOTES AND WARNINGS ************************

Number of bootstrap samples for bias corrected bootstrap confidence intervals:
5000

Level of confidence for all confidence intervals in output:
    95.00
```

```
------ END MATRIX -----
```

Chapter Six

Discussions and Implications

6.1 Discussion

The study began because Lebanon was thought to have a weak legal system and organizations throughout the nation did not efficiently implement corporate governance structures. Strong corporate governance within firms is of utmost importance as it increases corporate performance. If countries were to improve the perceived strength of their legal system, then they would aid in the implementation of corporate governance within organizations. Also, the nation and economy, as a whole, will benefit from the increased financial performance. Due to the special case that the survey only included the Lebanese population four hypotheses were formulated as following:

H1: The perception of the strength of the legal system has a positive correlation with Financial Performance.

H2: The perception of the strength of the legal system has a positive correlation with Corporate Governance.

H3: Corporate Governance has a positive correlation with Financial Performance.

H4: Corporate Governance mediates the relationship between the perception of the strength of the Legal System and Financial Performance.

The results raised four main points of discussion:

1) Awareness, perceived enforcement of the legal system, and international acts, as well as the overall perception of the strength of the legal system, have significant positive relationship with change in performance.

2) Benefits attained directly from the awareness and perception of the strength of the legal system has to be through better corporate governance practices.

3) Ownership component of corporate governance fully mediates the relationship between the perception of the enforcement of the legal system and change in performance.

4) The perception of the enforcement of the legal system leads to better performance overtime through better corporate governance practices especially in terms of the ownership components.

6.2 Implications

In regards to the points discussed above, Lebanese companies and in particular SMEs seeking to enhance their financial performance are recommended to enhance the perception of the Lebanese Legal System (provisions regarding corporate governance) and the way this legal system is enforced, in order to ensure the continuity of proper corporate governance practices overtime specially in terms of the ownership components. Also, the Lebanese government is recommended to draft new laws and regulations which enforce proper governance in firms and increase awareness of the strength and enforcement of the Lebanese legal system, in order to oblige Lebanese firms to abide by the legal rules and in order to encourage further foreign investments.

Chapter Seven

Conclusions and Recommendations

7.1 Summary

This research study was designed to investigate the mediating effect of corporate governance on the relationship between the perception of the strength of the legal system and financial performance.

The first chapter was an introduction to the topic. This chapter included an overview and background of the research subject, the need for the study and why it is important, the research objective, relevance of the research, and the limitations of this study. The second chapter was the literature review which was comprised of all previous studies about this topic. The subtitles, or areas of research, included searching prior research on corporate governance, corporate governance and financial performance, corporate governance and the legal system, the effect of the legal system on corporate governance and financial performance, corporate governance in Lebanon, and corporate governance in MENA region.

The third chapter, hypothesis development, referred to the formulation of the hypotheses for this study which was supported by a diagram that illustrates this notion. The fourth chapter is the methodology section, which provides information about the methods used to accept the hypotheses. This includes a section on the research design, sample and questionnaire, and instrumentation of the research process.

Chapter five was the chapter on the statistical analyses of the study. This chapter included descriptive statistics within it such as bar graphs, tables, reliability studies, and correlation

and mediation analysis. These instruments are what aided the acceptance of our hypotheses for the study.

Finally, chapter six involved a discussion on the research results. These results revealed that the perception of the enforcement of the legal system leads to better performance overtime through better corporate governance practices especially in terms of the ownership components.

7.2 Conclusions and Recommendations

In conclusion, this study has succeeded in proving that the ownership component of corporate governance fully mediates the relationship between the perception of the enforcement of the legal system and change in performance. Lebanese SMEs in general are recommended to adopt a Code of Corporate Governance and increase their perception of the strength of the Lebanese legal system to ensure proper governance structures in order to improve their overall performance.

7.3 Future Research

Future research within this topic is necessary and can be conducted within the fields of law and a nation's system. New and innovative theories can be practiced and reached out to the government. Other variables may effect corporate governance and financial performance as well. Such variables include the structure of the organization, the motivation of board members to implement such structures, and also choosing a new approach beneficial to the nation within our legal system.

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