

THE IMPACT OF EQUITY FINANCING ON FINANCIAL PERFORMANCE: EVIDENCE FROM JORDAN

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Abstract: The main objective of this study is to examine the impact of equity financing on the financial performance of Jordanian industrial companies. The study population comprised 393 board directors from 55 Jordanian industrial companies. Purposive sampling was employed to select 346 board directors for the study sample. Data were collected via an online questionnaire, and the study used a descriptive-analytical approach to examine the study hypotheses. The study concludes that equity financing positively impacts financial performance. Also, each of the angel investors, retained earnings, crowdfunding, and ploughed-back profit positively impact financial performance. The study recommends that Jordanian industrial companies focus on retained earnings as a funding source; what helps is the lower costs of obtaining financing from retained earnings compared with other funding sources. This study is unique because, as far as the researcher knows, it is the first to look at how angel investors, retained earnings, crowdfunding, and ploughed-back profit affect the financial performance of Jordanian industrial companies all at the same time or separately.

Keywords: angel investor, crowdfunding, equity financing, ploughed-back profit, retained earnings, return on equity.

JEL Classification: G00, L00.

1 Introduction

Understanding the impact of equity financing on financial performance is important for investors and company management. It can provide insights into how the choice of financing method can affect a company's profitability, growth potential, and overall value. In contrast, Modigliani and Miller (1958) indicate that a firm's value is more influenced by the market value of its financial assets and the associated risks and returns than by its capital structure.

Equity financing is a crucial aspect of corporate finance, as it involves raising funds by issuing shares of ownership in a company. Capital financing is a viable alternative for acquiring the requisite money to enhance financial performance. This method allows companies to raise capital for their operations, meet financial obligations, and pursue investment opportunities (Myers and Majluf, 1984).

However, due to prevailing local and global economic circumstances, enterprises increasingly need enhanced access to financial resources. Corporations depend on internal and external funding sources to establish their

capital structure (Abor, 2005; Njagi, et al., 2017). Equity financing does not create a debt burden for the company. Unlike debt financing, which involves borrowing money that needs to be repaid with interest, elevated interest rates on loans can also diminish their capacity to secure financial assistance. Instead, shareholders become partial company owners and share profits and losses.

According to Myers and Majluf (1984), the pecking order theory posits that organizations prefer internal financing over external debt sources when the cost of obtaining debt financing is elevated. Additionally, McLaughlin, et al. (1996) asserted that firms with growth prospects and investment possibilities tend to select equity financing over debt financing. Myers (2001) further underlined that this strategic choice enhances a shareholder value by optimizing the capital structure.

Hence, it is common practice for companies to adhere to a hierarchical approach when funding their operations. This strategy involves prioritizing internal finance as the first option, then debt financing, and

finally turning to the sale of shares as a means of financing (Njagi, et al., 2017). Furthermore, Abor (2005) highlighted that corporations adhere to a hierarchical approach when funding their investments. Initially, they prioritize internal sources, such as retained profits. Subsequently, they turn to debt as an alternative and ultimately issue shares.

Researchers at the international level have shown considerable interest in examining the influence of equity financing on financial performance. Furthermore, Abor (2005) highlighted that corporations adhere to a hierarchical approach when funding their investments. Initially, they prioritize internal sources, such as retained profits. Subsequently, they turn to debt as an alternative and ultimately issue shares. Hence, it is common practice for companies to adhere to a hierarchical approach when funding their operations. This strategy involves prioritizing internal finance as the first option, then debt financing, and finally turning to the sale of shares as a means of financing.

Businesses that relied more on equity financing had better long-term performance than those that relied heavily on debt financing (Njagi, et al., 2017). In contrast to the findings of McLaughlin, et al. (1998), companies that secure funding through the issuance of shares exhibit subpar long-term performance. In addition, Barberis, et al. (1998), Daniel, et al. (1998), Hong and Stein (1999), Polk and Sapienza (2004), and Titman, et al. (2004) have found that the issues of shares often lead to a period of low returns. According to Halstead and Landgren (2015) and Pape (2014), there is evidence to indicate that angel investors positively impact financial performance. Simultaneously, Basse, et al. (2015) showed a positive impact of ploughed-back profit on financial performance.

In contrast, there needs to be more focus on examining the impact of equity financing on financial performance at the local level. In their study, Al-Zararee, et al. (2021) observed a statistically significant relationship between the capital structure and the return on equity (ROE) of industrial companies in Jordan. In a study conducted in 2012, Shubita and Alsawalhah examined the relationship between the capital structure and the profitability of industrial companies in Jordan. It has been shown that companies that generate substantial revenue predominantly depend on equity as their principal means of funding.

The existing body of literature indicates that numerous international studies have been conducted on equity financing and its impact on financial performance. The results obtained from the studies above cannot be generalized to Jordanian industrial companies. However, it is important to note that more research studies are needed to examine the impact of equity financing on the financial performance of Jordanian industrial companies. This study is an initial attempt to investigate the impact of equity financing on the financial performance of Jordanian industrial companies.

The primary objective of this study is to address the existing knowledge gaps in the literature. This study additionally enhances the understanding of investors and company management regarding the impact of equity financing on a firm's financial performance. The elucidation of consequences is enhanced, facilitating firm managers' accurate strategic planning of the equity financing process. Furthermore, it aids governmental entities and policymakers in formulating effective policies about equity financing.

As a result, the study's main question relates to the following problem statement: Does equity financing impact financial performance?

The main question gives rise to the following subsidiary questions:

1. To what extent do angel investors impact financial performance?
2. Do retained earnings impact the financial performance?
3. To what extent does crowdfunding impact financial performance?
4. Do ploughed-back profits impact financial performance?

The primary aim of this study is to examine the impact of equity financing on financial performance. The secondary aims of this study are as follows:

1. Examine the impact of angel investors on financial performance.
2. Assess the impact of retained earnings on financial performance.
3. Analyze the impact of crowdfunding on financial performance.

4. Elucidate the impact of ploughed-back profits on financial performance.

This study is composed of various sections. The initial section provides an overview of the theoretical framework, delineates the study problem, outlines the objectives, and formulates the study questions. The subsequent section analyzes the theoretical framework and the formulation of hypotheses. The third section of the paper elucidates the methodology employed in the study, including details on the study population, sample selection, study model, and study instrument, as well as the assessment of validity and reliability. The fourth phase of the study encompasses a comprehensive statistical analysis, which contains several techniques such as descriptive analysis, correlation analysis, hypothesis testing, and a thorough discussion of the obtained data. The fifth portion encompasses the conclusion, recommendations, and restrictions.

2 Theoretical framework and hypothesis development

2.1 Equity financing

Equity financing is a valuable component of a company's capital structure. It allows businesses to raise funds without incurring debt or interest payments. By selling ownership shares to investors, companies can obtain the capital they need to grow and expand their operations. This approach is precious for start-ups and small businesses that may need help accessing traditional forms of financing. Additionally, equity financing grants investors a stake in the company's ownership, aligning their interests with the business's success (Bloom, et al., 2015). This can lead to increased company support, expertise, and networking opportunities. Overall, equity financing gives businesses the capital to fuel innovation, pursue growth opportunities, and achieve long-term financial success.

Equity financing can be derived from various external resources. For example, companies may seek capital from venture capital firms, which specialize in funding high-growth start-ups. Another source of external equity financing is angel investors, typically wealthy individuals who invest their money in promising businesses. Additionally, companies can raise funds through crowdfunding platforms, where individuals contribute small amounts of money in exchange for

shares or rewards. These external resources provide businesses with alternative avenues for raising capital and expanding their financial resources (Fraser and Stuart, 2005).

Moreover, equity financing is crucial to a company's capital structure, encompassing retained earnings, reinvestment in the business, angel investors, member contributions, and crowdfunding (Choi, 2014; Kizito, 2017).

Examining the influence of equity financing on financial performance has garnered significant scholarly interest. Many previous studies have looked at how equity financing affects financial performance. Based on these studies, most theoretical frameworks agree that equity and debt are the main ways to get money. Nevertheless, these endeavors have had diverse outcomes, encompassing both favorable and unfavorable consequences or, in some cases, exhibiting no discernible impact.

Previous studies have extensively examined the relationship between equity financing and financial performance. For example, Yator and Gitagia (2023) studied manufacturing companies listed on the Nairobi Securities Exchange and found that equity funding statistically affects financial performance. Similarly, Caroline and Willy (2015), Njagi, et al. (2017), and Zhang, et al. (2019) all conducted studies that demonstrated a positive impact of equity financing on financial performance. In addition, Ferati and Ejupi (2012) concluded that the ROE positively impacts equity. On the other hand, the Gatauwa (2022) study did not find a statistically significant correlation between equity funding and financial performance. Furthermore, Musila (2015) discovered a statistically insignificant yet positive correlation between equity funding and financial performance. In contrast, Zeitun and Tian (2007), Liu (2014), Lyu and Chen (2022) indicated a negative correlation between equity financing and corporate performance.

It is important to note that these studies employed various methodologies, including quantitative financial data analysis and company executive surveys. While previous studies have examined the relationship between equity financing and financial performance, there needs to be more research studies conducted in local contexts. This study seeks to fill that gap by in-

investigating the influence of equity financing on the financial performance of industrial enterprises in Jordan. This is important because Jordan's business landscape may have unique characteristics and challenges that can affect the relationship between equity financing and financial performance. By conducting the study in Jordan, valuable insights can be gained that are specific to the local context, allowing businesses and policymakers to make informed decisions regarding capital financing strategies and their impact on financial performance.

Based on the preceding information and in alignment with the objective of the study, the following hypothesis was formulated:

H1: Equity financing positively impacts financial performance.

2.1.1 Angel investors

Angel investors are wealthy individual entrepreneurs who offer financial backing to enterprises, particularly during their early stages, in return for a share of ownership in the company. In addition, they provide guidance derived from their extensive expertise. The significance of individuals resides in their dedication to adaptable investments in the organization, wherein their contribution may vary in magnitude and duration, including both modest or huge amounts and one-time or continual support. Angel investors play a crucial role in the success of early-stage enterprises. By providing financial backing, they give these companies access to much-needed capital that may require more than traditional funding sources. Additionally, angel investors often bring extensive expertise and industry knowledge to the table, offering valuable guidance and mentorship to entrepreneurs. Their involvement can also open doors to meaningful industry connections and networks, which can further enhance the growth and development of the company (Adesina, et al., 2015).

There are divergent viewpoints about the influence of angel investors on financial performance. Pape (2014) and Halstead and Landgren (2015) conducted studies that showed a positive impact of angel investors on financial performance. They found that companies with angel investors experienced higher revenue growth, increased profitability, and improved market positioning

compared to those without angel investor involvement. On the other hand, Noor (2020) presented findings that indicate a negative effect of angel investors on financial performance. According to Noor's study, companies with angel investors had lower profitability and higher debt levels. Similarly, Njagi, et al. (2017) found that angel investors still need help achieving widespread acceptability as a funding source, suggesting their impact on financial performance may be positive. In addition, many successful large companies that attracted venture capitalists or public equity relied first on angel investors (El-Sayed, 2009).

The intended objective of this research is to investigate the impact of angel investors on financial performance. By formulating the sub-hypothesis that angel investors positively impact financial performance, we aim to contribute to the existing body of knowledge and provide insights into the role of angel investors in driving financial success for companies.

This hypothesis is based on the assumption that angel investors bring valuable financial resources, expertise, and networks to the companies they invest in. By analyzing the financial performance of companies with angel investors compared to those without, we can assess the extent of this impact and uncover any specific factors or mechanisms contributing to this positive influence.

Consequently, drawing from the prior information and aligning with the intended objective of the research, we formulated the initial sub-hypothesis as follows:

H1.1: Angel investors positively impact financial performance.

2.1.2 Retained earnings

There is a divergence of viewpoints about the impact of retained earnings on financial performance. Notably, Tirmizi and Ahmad (2013) argue that retained earnings positively impact financial performance by providing a stable source of internal financing that can be used for investments and growth. They suggest that companies with higher retained earnings are more likely to have more robust financial performance indicators such as profitability and return on assets. On the other hand, Mwangi, et al. (2016) found an insignificant positive relationship between retained earnings and financial performance. Their study examined

many companies and analyzed various financial performance indicators. They argue that while retained earnings may provide internal financing, other factors, such as market conditions and management decisions, play a more significant role in determining financial performance. For example, they found that companies operating in highly competitive industries or facing unfavorable market conditions may not experience a significant positive impact from retained earnings alone.

Similarly, Kamau (2010) demonstrated a weak relationship between retained earnings and financial performance. Their study highlighted that factors such as the company's size and capital structure impacted the effects of retained earnings, which varied across industries. These findings suggest that the impact of retained earnings on financial performance may be contingent upon specific industry dynamics and company characteristics.

Farooq, et al. (2017) examined the relationship between retained earnings and return on assets (ROA) in a sample of companies. They found that companies with higher retained earnings had a higher ROA, suggesting that retained earnings contribute to improved financial performance. For example, they analyzed companies' financial statements in the technology sector. They found that those with higher retained earnings could invest in research and development, leading to the development of innovative products and increased profitability. Similarly, Tshabalala (2017) emphasized that retained earnings can be used for various purposes, contributing to improved financial performance. For instance, companies with higher retained earnings can invest in expansion projects, leading to increased market share and revenue generation. They can also use retained earnings to reduce debt, resulting in lower interest expenses and improved profitability.

Tirmizi and Ahmad (2013) conducted a study analyzing the financial performance of companies with high retained earnings compared to those with lower levels. They found that companies with higher retained earnings had higher profitability ratios, positively impacting financial performance. Similarly, Farooq, et al. (2017) examined the relationship between retained earnings and return on assets (ROA) in a sample of companies. They found that companies with higher re-

tained earnings had a higher ROA, suggesting that retained earnings contribute to improved financial performance.

Furthermore, companies have consistently reported high retained earnings, allowing them to invest in research and development, expand their operations, and maintain strong financial performance. However, it is important to consider that the impact of retained earnings on financial performance may vary across different industries and company contexts. Market conditions, competition, and management decisions can influence financial performance, making it difficult to attribute the positive impact solely to retained earnings.

Additionally, while retained earnings may provide a stable source of internal financing, they may also indicate a lack of investment opportunities or a conservative financial strategy. In such cases, companies with high retained earnings may have less robust financial performance than those actively seeking external financing options for growth and expansion.

While companies with high retained earnings may indicate a conservative financial strategy, it is important to note that this approach has potential benefits. A traditional financial strategy can provide stability and financial security for the company, especially during periods of economic uncertainty or market downturns. By retaining earnings, companies can build a financial cushion that can be used to weather financial challenges and ensure long-term sustainability. Additionally, a conservative financial strategy can be seen as a sign of prudent financial management, as it indicates that the company is not overly reliant on external financing options and prioritizes financial stability and risk management.

This hypothesis suggests that companies with higher retained earnings will likely have better financial performance. However, it is important to note that the extent of this impact may differ depending on the specific industry and other factors such as the size and capital structure of the company. Therefore, further analysis is needed to understand the relationship between retained earnings and financial performance more nuancedly.

Consequently, drawing from the information above and in alignment with the research objectives, we formulated the second sub-hypothesis as follows:

H1.2: Retained earnings positively impact financial performance.

2.1.3 Crowdfunding

Crowdfunding is a form of external financing that involves the acquisition of funds by a firm from individuals within its social network, such as family members and friends, without any monetary obligations during the initial stages of its establishment. Hence, it plays a significant role and substantially influences the organization's financial performance and prospective success (Yazdanfar and Öhman, 2015).

Nevertheless, there are divergent viewpoints regarding the influence of crowdfunding on financial success. Notably, Mwangii, et al. (2016), Blouin, et al. (2018) and Noor (2020) argue that crowdfunding has a positive impact on financial performance due to its ability to provide access to capital from a vast network of individuals. This can lead to increased project funding, reduced reliance on traditional financing sources, and improved financial outcomes. Similarly, research by Hategan and Curea-Pitorac (2017) discovered that businesses that use crowdfunding perform better financially than those that do not. This suggests that crowdfunding can offer a source of capital unrestricted by conventional financing barriers. Additionally, studies have shown that successful crowdfunding campaigns can signal investor confidence and attract additional investors, further boosting financial performance.

On the other hand, Cheboi (2014) presents a different perspective, suggesting that crowdfunding may have a negative relationship with financial performance. They argue that relying on crowdfunding can signal financial distress and may deter other potential investors, leading to lower financial performance. Including these additional viewpoints can provide a more comprehensive analysis of the impact of crowdfunding on financial success.

Crowdfunding is expected to have a positive impact on financial performance due to several reasons. Firstly, crowdfunding can access capital from a vast network of individuals, allowing firms to secure funding that may not be available through traditional financing

sources. Increased capital availability can support the growth and development of the firm, leading to improved financial performance. Additionally, crowdfunding can reduce the reliance on traditional financing methods, which may have stricter requirements and limitations. By diversifying their funding sources, firms can mitigate risks and improve their financial stability. Furthermore, successful crowdfunding campaigns can signal investor confidence and attract additional investors, further boosting financial performance.

While crowdfunding can positively affect financial performance, it is important to acknowledge its limitations. One limitation is the reliance on personal networks for funding. Crowdfunding campaigns often rely on individuals within the firm's social network, such as family members and friends, to contribute funds. While this can provide initial support, it may limit the pool of potential investors and not provide access to more prominent institutional investors. This can restrict the available funding and determine the firm's growth potential.

Additionally, maintaining transparency and accountability can be challenging in crowdfunding campaigns, as there may be limited regulatory oversight, compared to that in traditional financing methods. Firms relying on crowdfunding must have robust mechanisms to address transparency and accountability challenges. This can include providing regular updates to investors, being clear and transparent about using funds, and implementing mechanisms for feedback and communication with investors. Furthermore, overreliance on crowdfunding can pose risks, as it may signal financial distress and deter other potential investors. It is important for firms to carefully consider their financing strategies and diversify their funding sources to mitigate these risks.

In conclusion, crowdfunding has the potential to positively impact financial performance by providing access to a vast network of individuals for capital, reducing reliance on traditional financing methods, and signaling investor confidence. However, it is important to consider the limitations of crowdfunding, such as the reliance on personal networks for funding and the challenges of transparency and accountability. Firms should carefully consider their financing strategies and diversify their funding sources to mitigate

risks. By understanding the potential benefits and limitations of crowdfunding, firms can make informed decisions to improve their financial performance.

Consequently, with the prior information aligned with the objective of the investigation, we formulated the subsequent third sub-hypothesis as follows:

H1.3: Crowdfunding positively impacts financial performance.

2.1.4 Ploughed-back profits

Ploughed-back profits, also known as retained earnings, are the portion of company's profits that are not distributed to shareholders as dividends but instead re-invested into the company. This method of financing allows the company to use the profits to fund its expansion and modernization efforts. Keeping the profits within the company means that there is no immediate pressure to distribute them to shareholders. This also helps to maintain the company's capital structure and reduces the need to rely on external funding sources (Oladeji, 2015). Additionally, ploughed-back profits can be used as a form of equity financing, allowing the company to recover the profits as part of its capital instead of using them to finance other projects. This is considered a less risky internal financing source than alternatives (Yazdanfar and Öhman, 2015).

Opposing opinions exist about whether ploughed-back profits impact financial performance. Studies conducted by Masood (2013), Bassey, et al. (2015), and Edom and Aganyi (2015) have found a positive impact of ploughed-back profits on financial performance. These studies suggest that companies that reinvest their profits into the business experience improved financial performance compared to companies that distribute all profits to shareholders. In addition, Njagi, et al. (2017) revealed that small- and medium-sized enterprises (SMEs) tend to have a greater preference for contributions from friends and ploughing-back profit as a source of equity finance, indicating that ploughing-back profits can play a significant role in the financial operations of these companies. In contrast, Noor (2020) found a negative impact of ploughed-back profits on financial performance. These conflicting findings highlight the need for further research and analysis to fully understand the relationship between ploughed-back profits and financial performance.

Therefore, based on the preceding discussion on ploughed-back profits and the conflicting findings on their impact on financial performance, this study aims further to investigate the relationship between ploughed-back profits and financial performance. Specifically, the fourth sub-hypothesis seeks to determine the extent to which ploughed-back profits contribute to the overall financial performance of companies. By examining this relationship, the study aims to provide valuable insights for companies in deciding how to allocate their profits and make informed decisions about equity financing options. The findings of this study will contribute to the existing literature on corporate finance and provide practical implications for managers and stakeholders. Therefore, we developed the following fourth sub-hypothesis:

H1.4: Ploughed-back profits positively impact financial performance.

2.2 Financial Performance

Financial performance refers to the ability of an entity to accomplish well-defined objectives within a designated period. Hence, evaluating the outcomes of pre-determined objectives verifies enhanced performance or deficiencies. Moreover, performance assessment can be conducted using several approaches, encompassing both quantitative and non-quantitative methodologies. Therefore, financial institutions' performance is frequently evaluated by analyzing their published financial statements (Muritala, 2012). Furthermore, Deloof (2003) has defined performance as the capacity of a company to effectively utilize its resources and execute its strategies to cultivate its competitive advantages. This encompasses both financial and non-financial dimensions, indicating the coexistence of both types of performance.

A firm's financial performance is contingent upon its management's efficacy in effectively overseeing and operating assets while ensuring the maintenance of favorable levels of liquidity. Hence, shareholders assess the company's financial performance by evaluating investors' profitability from their initial investment. This evaluation is conducted by analyzing financial statements using diverse financial ratios, which indicate the company's ability to meet its objectives (Berger and Bonaccorsi, 2006; Siddiqui and Shoaib, 2011).

Financial performance is a crucial aspect of evaluating a company's success. Financial performance is typically assessed by analyzing a company's financial statements, which provide information on its assets, liabilities, revenues, and expenses. It can be evaluated through various metrics and financial ratios, including return on assets (ROA) and equity (ROE), which measure the company's profitability and efficiency in utilizing its resources. The return on assets (ROA) is calculated by dividing net income by total assets, and the metric evaluates the company's effective management of its assets and capacity to generate profits through its operations. On the other hand, return on equity is calculated by dividing net income by shareholders' equity, and the metric indicates a company's capacity to generate profits from the investments made by its shareholders; it quantifies the return that stockholders achieve on their investments. These ratios provide insights into the company's ability to generate profits from its operations and investments, respectively, and can help shareholders assess its financial performance and provide insights into the company's effectiveness in leveraging financial strategies to maximize profitability (Berger and Bonaccorsi, 2006; Mahoney, et al., 2008; Samiloglu and Demirgunes, 2008; Fauzi and Idris, 2009; Croce, et al., 2018).

According to Khrawish (2011), a higher quality indicator indicates a company's more efficient and effective management of shareholders' funds. In contrast, when the equity ratio experiences a fall, it suggests that the company has relied more on debt to finance its operations and fulfill its financial responsibilities. A company with a high return on assets (ROA) and return on equity (ROE) indicates that it effectively utilizes its resources and generates profits for its shareholders. This can attract more investors and increase the company's market value. On the other hand, a company with a low ROA and ROE may indicate inefficiencies in its operations or poor financial management, which can lead to decreased investor confidence and potential financial difficulties for the company (McLaughlin, et al., 1996).

It is important to note that financial performance evaluation through financial ratios has limitations. One limitation is that financial statements may not always accurately reflect a company's actual financial posi-

tion, as accounting practices can vary and may be subject to manipulation. Additionally, changes in market conditions or the impact of external factors, such as economic downturns or regulatory changes, can affect a company's performance and make it difficult to evaluate its financial performance solely based on historical data.

Many theories have discussed capital financing and explained the relationship between capital structure and company performance.

2.2.1 Modigliani and Miller Theory

Modigliani and Miller (1958) theories of capital structure suggest that a company's value is not affected by its capital structure when there are no taxes, and its cost of equity increases linearly as a function of its debt-to-equity ratio. When there are taxes, the value of a levered company is always higher than that of an unlevered company, and the cost of equity increases as a function of the debt-to-equity ratio and tax rate.

Equity financing is one of the ways companies can raise capital. It involves selling company ownership shares to investors in exchange for cash. The amount of equity financing a company uses affects its capital structure, affecting its cost of equity. According to M&M theories, the cost of equity increases linearly as a function of the company's debt-to-equity ratio.

2.2.2 Free Cash Flow Theory

Managers prefer to keep the excess cash flow, even though it can be invested in investments with a positive net present value. Nevertheless, the problem appears in how managers pay cash dividends and oblige the company to pay debts, which reduces the cash balance, in contrast to share issuance, which leads to increased cash flows (Jensen and Meckling, 1976).

Free cash flow theory and equity financing are closely linked because equity financing represents a significant fund source for company investments and operations. How a company applies Free Cash Flow Theory principles to allocate and manage the capital obtained through equity financing can profoundly impact its financial health, growth, and shareholder value creation. The theory guides companies to use equity financing

strategically to enhance the Free Cash Flow Theory and maximize shareholder wealth.

2.2.3 Pecking Order Theory

The theory suggests that companies have a hierarchy of preferred financing sources; therefore, the company chooses to finance from internal sources, such as retained earnings, rather than external sources, such as borrowing, and finally, equity financing. However, determining the ideal financing strategy is difficult (Myers and Majluf, 1984; Arrondo-García, et al., 2016; Njagi, et al., 2017).

In contrast, debt financing could positively or negatively impact companies' performance (Weill, 2008), whereas Margaritis and Psillaki (2010) and Chisti, et al. (2013) found a positive impact. By contrast, Ebel Ezeoha (2008), Habib, et al. (2016), Sadiq and Sher (2016), and Aziz and Abbas (2019) found a negative impact of debt financing on corporate profitability, which confirms the pecking order theory.

Equity financing is considered a source of capital that companies turn to when internal funds and debt options are insufficient, so it is generally considered the least preferred funding source. Companies may choose to use other sources of financing before resorting to equity financing, depending on their perceived financial and external market conditions.

2.2.4 Market Timing Theory

In market timing theory, companies prefer equity financing only when its costs are relatively low; otherwise, financing by debt is more appropriate (Baker and Wurgler, 2002).

The relationship between market timing theory and equity financing lies when a company issues equity to raise capital. However, it is essential to note that accurately timing the market is challenging. Critics argue that market timing theory is based on the assumption that companies can accurately time the market, which is difficult in practice.

The theory relates to this study by helping understand the relationship between equity financing components and financial performance. It justifies why a company uses retained earnings and angel investors as funding sources, supporting that equities' key components

comprise retained earnings and ploughed-back profits to ensure financial performance (Hovakimian, 2006).

2.2.5 Trade-off Theory

The trade-off theory suggests that companies should carefully evaluate different forms of financing, such as debt and equity, to determine the optimal capital structure. This theory is based on the idea that trade-offs are associated with each financing form. For example, debt financing allows companies to benefit from tax advantages and leverage, but it also comes with the obligation to make interest payments and the risk of financial distress. On the other hand, equity financing allows companies to avoid interest payments and retain control. Still, it can lead to a dilution of ownership and the expectation of providing returns to shareholders. In light of these trade-offs, companies strive to balance debt and equity financing that aligns with their financial objectives and risk appetite.

Research by Myers and Majluf (1984) has shown that corporations prioritize internal sources of financing, such as retained profits, over debt. This is because debt financing comes with the obligation to make interest payments and the risk of financial distress. Similarly, Glover and Hambusch (2014) found that equity financing offers certain benefits, such as avoiding interest payments and retaining control. However, they also found that equity financing can lead to dilution of ownership and the expectation of providing returns to shareholders. These studies provide evidence to support the claim that there are advantages and disadvantages associated with equity financing and that companies need to consider these trade-offs carefully when determining their capital structure.

Further research by Graham and Harvey (2001) found that companies with higher financial leverage tend to experience higher bankruptcy risk, which supports the trade-off theory's emphasis on the risk of financial distress associated with debt financing. Additionally, a study by Rajan and Zingales (1995) showed that companies with higher equity financing tend to have lower agency costs and greater alignment of interests between managers and shareholders. These studies provide additional evidence to support the trade-off theory's claims about the advantages and disadvantages of debt and equity financing.

The acknowledgment is that equity financing possesses certain benefits, such as avoiding interest payments and retaining control. However, it is also acknowledged that there are negatives associated with this form of financing, including dilution of ownership and the expectation of providing returns to shareholders. In pursuit of their financial objectives and risk appetite, organizations strive to achieve a harmonious combination of equity and debt financing (Myers, 2001; Glover and Hambusch, 2014).

While the trade-off theory provides a valuable framework for companies to evaluate different financing forms, some critics argue that the trade-off theory oversimplifies the decision-making process by assuming companies only consider debt and equity financing options. They contend that companies may also explore alternative sources of financing, such as venture capital or crowdfunding, which may have their trade-offs. While these criticisms are valid, it is important to note that the trade-off theory still provides a valuable framework for evaluating the advantages and disadvantages of debt and equity financing, which remain the most common forms of financing for many companies.

3 Methodology

3.1 Research design

This study used a descriptive-analytical approach to test the impact of equity financing on financial performance. In addition, we used SPSS software version 26 to test the study's hypotheses.

SPSS software is widely used in social science research for its robust statistical analysis capabilities and user-friendly interface. It provides a comprehensive suite of tools for data management, data exploration, and hypothesis testing. In this study, SPSS was chosen because it allows for the analysis of multiple variables and their relationships, which aligns with the research objectives of examining the impact of equity financing on financial performance. The software's regression analysis, correlation analysis, and descriptive statistics functions were utilized to analyze the data collected from the questionnaire and financial reports. Using SPSS, the researcher conducted rigorous and accurate statistical analysis, ensuring the reliability and validity of the study's findings.

The descriptive-analytical approach was chosen for this study because it allows for a detailed description and analysis of the variables involved in the study. This approach is beneficial when the aim is to provide a comprehensive understanding of the impact of equity financing on financial performance. By employing this strategy, we gathered and analyzed information on financial performance indicators, such as return on equity, and investigated how equity financing affects them. The descriptive-analytical approach also allows for identifying patterns and trends in the data, providing valuable insights into the relationship between equity financing and financial performance.

3.2 Study population and sample

This study included 55 Jordanian industrial firms. The population of the study consisted of 393 board directors. In contrast, the study sample involved 346 board directors, who were selected using purposive sampling.

The selection criteria for the sample included individuals who had at least five years of experience as a board director and were currently serving in that role. To ensure a diverse sample, we also aimed to include individuals from companies of varying sizes and industries. This approach allows for the inclusion of board director members who directly influence financial decision making within Jordanian industrial companies, providing valuable insights into the impact of equity financing on financial performance.

The selection criteria for the sample were carefully determined to ensure that the included board directors would provide valuable insights into the impact of equity financing on financial performance. The requirement of at least five years of experience as a board director was chosen to ensure that the respondents had sufficient knowledge and expertise in financial decision making within Jordanian industrial companies. The study captured real-time insights and perspectives on the relationship between equity financing and financial performance by including individuals currently serving as board directors. Additionally, the aim of including individuals from companies of varying sizes and industries was to ensure a diverse sample representing the broader Jordanian industrial sector. This diversity allows for a more comprehensive

understanding of how equity financing affects financial performance across different contexts and organizational characteristics.

3.3 Study Model

Figure 1 shows the proposed study model, which explains the impact of equity financing on financial performance.

The proposed study model (Figure 1) includes several vital variables central to understanding the impact of

equity financing on financial performance. The independent variable, equity financing, represents the proportion of a company's capital funding through angel investors, retained earnings, crowdfunding, and ploughed-back profit. The dependent variable, financial performance, refers to a company's financial health and success. By examining these variables and their relationships, this study aims to provide insights into how equity financing can impact the financial performance of Jordanian industrial companies.

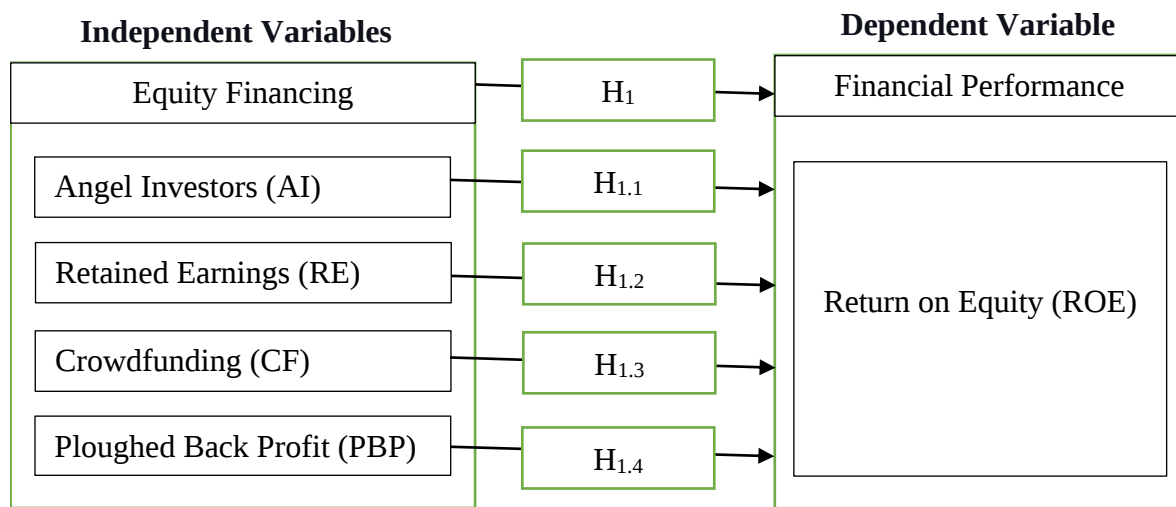


Figure 1. Study model
(Source: Author's own research)

3.4 Data collection and procedures

Based on several previous studies by Musila (2015), Njagi, et al. (2017), and Noor (2020), we developed a study instrument to obtain data from the respondents.

The questionnaire comprised five dimensions. The first dimension covers the angel investor dimension, representing the proportion of a company's capital funding obtained from angel investors. The second dimension covers retained earnings, representing the proportion of a company's capital funding derived from retained earnings. The third dimension covers the crowdfunding dimension, expressing the proportion of a company's capital funding obtained through crowdfunding platforms. The fourth dimension covers the ploughed-back profits dimension, which represents the proportion of a company's capital funding reinvested from profits. By examining these dimensions and their

relationship with financial performance, the study aims to gain insights into how different equity financing sources can impact the financial performance of Jordanian industrial companies. Financial performance represents the independent variable measured by ROE.

The study instrument used a five-point Likert scale extending from "strongly agree" to "strongly disagree." The Likert scale was chosen for its ability to capture nuanced responses and measure the strength of agreement or disagreement with each statement. This scale allows respondents to indicate their level of agreement or disagreement on a continuum, providing more detailed and reliable data for analysis. Additionally, the Likert scale is widely used in social science research and has established validity and reliability.

The researcher distributed 346 questionnaires, and the number of valid questionnaires for analysis was 314,

which reached 91%, representing an excellent response rate (Mugenda and Mugenda, 2009). In addition, we obtained financial data from the Jordanian industrial companies' annual financial reports.

3.5 Validity and reliability

In order to ensure the language integrity and clarity of meaning in the questionnaire, we presented it to a group of specialists with experience and competence in the field of study. These specialists carefully reviewed each question and section of the questionnaire and provided feedback on its language and clarity.

Based on their input, we made all the necessary corrections and revisions to ensure that the questionnaire was clear and understandable to participants.

The Cronbach's alpha coefficient measures internal consistency, indicating how much the questionnaire items correlate. A value of 0.70 or above is generally acceptable for research purposes. In our study, the values of Cronbach's alpha for each variable ranged between 0.831 and 0.870, exceeding the 0.70 threshold (Table 1). This indicates that the items within each variable are highly correlated and that the questionnaire demonstrates high internal consistency and reliability (Sekaran and Bougie, 2009; Hair, et al., 2010; Creswell and Creswell, 2017).

Table 1. Reliability analysis
(Source: Author's research)

Variables	Cronbach's alpha value
Angel Investors (AI)	0.831
Retained Earnings (RE)	0.834
Crowdfunding (CF)	0.837
Ploughed-Back Profit (PBP)	0.835
Return on Equity (ROE)	0.870

4 Statistical analysis

4.1 Descriptive analysis

The descriptive analysis provides important insights into the variables being studied. The mean and median values for retained earnings were the highest among all variables, indicating that, on average, companies in the sample had higher retained earnings than other variables. This suggests that retained earnings may be a significant factor in the financial performance of the companies. The standard deviation values for all variables were relatively similar, ranging from 0.66 to 0.70, suggesting no considerable variability within the dataset. This implies that the companies in the sample had similar levels of variability in their financial variables.

By referring to Table 2, we noted the following:

- The minimum value for angel investors, retained earnings, ploughed-back profit, and ROE was 1.00, while the maximum value for ROE was 5.00, followed by 4.80 for crowdfunding.
- The highest mean was 3.1286 for retained earnings, whereas the lowest mean was 2.596 for ROE.
- The highest median was 3.00 for retained earnings, whereas the lowest median was 2.50 for ploughed-back profit and ROE.
- The highest mode was 2.80 for crowdfunding, whereas the lowest mode was 2.25 for ploughed-back profit.
- Retained earnings had the highest mean and median values, reaching 3.12 and 3.00, respectively.

Table 2. Descriptive analysis
(Source: Author's research)

	AI	RE	CF	PBP	ROE
Mean	2.89	3.12	2.86	2.65	2.59
Median	2.75	3.00	2.80	2.50	2.50
Mode	2.50	2.75	2.80	2.25	2.50
Std. deviation	0.70	0.70	0.66	0.69	0.67
Minimum	1.00	1.00	1.60	1.00	1.00
Maximum	4.50	4.75	4.80	4.75	5.00
Sum	913.00	985.50	901.30	836.50	817.80
Note: AI: angel investors, RE: retained earnings, CF: crowdfunding, PBP: ploughed-back profit, ROE: return on equity.					

4.2 Correlation analysis

Before starting the hypotheses test, the researcher conducted the Pearson correlation coefficient test to ensure that there were no multiple linear correlations between the study variables. Based on the Pearson correlation rule, if the correlation value between the study variables reaches or exceeds 80%, then a multiple linear correlation problem exists between the study variables.

According to Table 3, all values were less than 80%; thus, the highest correlation value of 0.679 between angel investors and retained earnings suggests a positive relationship between these variables. This implies that companies with higher levels of angel investor

funding are more likely to have higher retained earnings. This finding is significant as it suggests that angel investors play a crucial role in companies' financial success. Similarly, the positive correlations between angel investors and crowdfunding (0.662) and retained earnings and crowdfunding (0.534) indicate that these variables are also related, although slightly less so. These findings suggest that there may be synergistic effects between different sources of funding for the companies. On the other hand, the lowest correlation of 0.477 between ploughed-back profits and ROE suggests a weaker relationship between these variables. This implies that ploughed-back profits may have less impact on the return on equity compared to other variables.

Table 3. Correlation analysis
(Source: Author's research)

	AI	RE	CF	PBP	ROE
AI	1.000	-	-	-	-
RE	0.679	1.000	-	-	-
CF	0.662	0.534	1.000	-	-
PBP	0.572	0.657	0.655	1.000	-
ROE	0.487	0.496	0.487	0.477	1.000
Note: AI: angel investors, RE: retained earnings, CF: crowdfunding, PBP: ploughed-back profit, ROE: return on equity.					

4.3 Hypotheses testing

4.3.1 Main hypothesis testing

H1: Equity financing positively impacts financial performance.

Table 4 shows that the value of R² was 0.325, which means that equity financing explains 32.5% of the variation in financial performance. The Durbin–Watson value is a measure of autocorrelation, which tests whether a relationship exists between the residuals of the regression model. A value of 1.846, within the acceptable limits, suggests no autocorrelation problem.

The F value measures overall significance, indicating whether the independent variable significantly impacts the dependent variable. In this case, the F value of 150.806 is more significant than the tabulated value, suggesting that equity financing significantly affects financial performance. The t-value measures the significance of the individual coefficients, with higher values indicating greater significance. A t-value of 12.280 at a significance level of 0.000 indicates that the coefficient for equity financing is highly significant. Therefore, the main study hypothesis was accepted.

Table 4. Results of the multiple linear regression
(Source: Author's research)

Dependent Variable						
	Independent Variable	B	Std. Error	Beta	T-test	Sig
Financial Performance (ROE)	Equity Financing	0.200	0.016	0.570	12.280	0.000
	R	0.570	-	-	-	-
	R ²	0.325	-	-	-	-
	Adjusted R ²	0.323	-	-	-	-
	F	150.806	-	-	-	-
	Durbin–Watson (DW)	1.846	-	-	-	-

4.3.2 Sub-hypothesis testing

First sub-hypothesis: Angel investors positively impact financial performance.

Table 5 shows that the value of R² was 0.237, indicating that angel investors interpret 23.7% of the change in financial performance. Furthermore, the Durbin–Watson value of 1.929 suggests no autocorrelation problem between the study variables. Accordingly, we accept the first sub-hypothesis based on the t-value of 9.856 at the significance level of 0.000.

Second sub-hypothesis: Retained earnings positively impact financial performance.

Table 5 shows that the value of R² was 0.246, indicating that retained earnings interpret 24.6% of the change in financial performance. Furthermore, the Durbin–Watson value of 1.898 suggests no autocorre-

lation problem between the study variables. Accordingly, we accept the second sub-hypothesis based on the t-value of 10.102 at the significance level of 0.000.

Third sub-hypothesis: Crowdfunding positively impacts financial performance.

Table 5 shows that the value of R² was 0.237, indicating that crowdfunding interprets 23.7% of the change in financial performance. Furthermore, the Durbin–Watson value of 1.949 showed no autocorrelation problem between the study variables. Accordingly, we accept the third sub-hypothesis based on the t-value of 9.854 at the significance level of 0.000.

Fourth sub-hypothesis: Ploughed-back profit positively impacts financial performance.

Table 5 shows that the value of R² was 0.227, indicating that ploughed-back profit interprets 22.7% of the change in financial performance. Furthermore, the Durbin–Watson value of 2.018 showed no autocorre-

lation problem between the study variables. Accordingly, we accept the fourth sub-hypothesis based on the t-value of 9.598 at the significance level of 0.000.

Table 5. Results of the simple linear regression
(Source: Author's research)

Variables	R	R ²	Adjusted R ²	Durbin–Watson	F Change	B	Std. Error	Beta	t	Sig.	Decision
AI → ROE	0.487 ^a	0.237	0.234	1.929	97.140	0.466	0.047	0.487	9.856	0.000	Accepted
RE → ROE	0.496 ^a	0.246	0.243	1.898	102.049	0.475	0.047	0.496	10.102	0.000	Accepted
CF → ROE	0.487 ^a	0.237	0.234	1.949	97.100	0.494	0.050	0.487	9.854	0.000	Accepted
PBP → ROE	0.477 ^a	0.227	0.225	2.018	92.126	0.464	0.048	0.477	9.598	0.000	Accepted
Note: AI: angel investors, RE: retained earnings, CF: crowdfunding, PBP: ploughed-back profit, ROE: return on equity.											

4.4 Results and Discussion

This study examines the impact of equity financing on financial performance. The study concludes that equity financing positively impacts financial performance, which is consistent with Ferati and Ejupi (2012), Caroline and Willy (2015), Musila (2015), Njagi, et al. (2017), Zhang, et al. (2019), and Yator and Gitagia (2023) but inconsistent with Zeitun and Tian (2007), Liu (2014), Lyu and Chen (2022), and Gatauwa (2022).

Equity financing has been shown to have a positive impact on the financial performance of companies. Equity financing allows companies to obtain capital from various sources, such as angel investors, retained earnings, crowdfunding, and ploughed-back profit. By accessing these financial resources, companies can expand their operations, invest in research and development, hire skilled employees, and acquire new assets. This influx of funds can fuel growth, increase market share, and enhance a company's competitive advantage. Furthermore, equity financing allows companies to share the financial risk with investors, providing stability and flexibility in uncertain economic conditions. Unlike debt financing, which requires regular interest payments and repayment of the principal amount, equity financing does not create an additional financial burden for companies. This allows companies to allocate more resources toward growth and development, ultimately improving financial performance.

While equity financing has been shown to have a positive impact on financial performance, it is important to acknowledge that there may be certain limitations or counterarguments to this finding, such as that equity financing may dilute the ownership stake of existing shareholders, which can lead to a loss of control and decision-making power. Additionally, companies that rely heavily on equity financing may face challenges in attracting investors, particularly if they have a limited track record or operate in a highly competitive industry. Furthermore, while retained earnings are considered a favorable funding source due to their low costs and lack of administrative burdens, they may not be sufficient to meet the capital needs of rapidly growing companies.

In addition, the study concludes that retained earnings positively impact financial performance, which is consistent with Tirmizi and Ahmad (2013), Tshabalala (2017), and Noor (2020) but inconsistent with Kamau (2010) and Mwangi (2016). It is also considered as the most significant factor affecting financial performance. This result means that Jordanian industrial companies favor retained earnings due to the low costs associated with obtaining them; therefore, it is considered the best source of capital financing. Unlike external funding sources such as angel investors or crowdfunding, retained earnings do not require companies to give up a share of their business or comply with disclosure and registration requirements. This makes retained earnings a more attractive option for companies, allowing them to maintain complete con-

trol over their operations and avoid additional administrative burdens. Furthermore, the availability of retained earnings within the company provides a sense of financial stability and independence, which can contribute to the company's overall financial performance. Moreover, the study concludes that angel investors positively impact financial performance, which is consistent with Pape (2014) and Halstead and Landgren (2015) but inconsistent with Noor (2020). In addition, the study concludes that crowdfunding positively impacts financial performance, which is consistent with Mwangi, et al. (2016), Hategan and Curea-Pitorac (2017), Blouin, et al. (2018), and Noor (2020) but inconsistent with Cheboi (2014). Most companies consider angel investors and crowdfunding as their secondary funding sources because finding a suitable angel investor and giving up a share of the business take longer, while crowdfunding needs to meet the disclosure and registration requirements imposed on parties seeking funding from the public. It may also introduce additional liquidity risk because it may require an active secondary market for crowdfunded shares. Thus, investors may only be able to liquidate their shares if they sell at a significant discount. Lastly, the study finds that ploughed-back profits positively impact financial performance, which is consistent with Masood (2013) and Bassey, et al. (2015) but inconsistent with Noor (2020). This indicates that managers may consider reinvesting more profits into the company to enhance growth and profitability. However, it is important to note that the availability of profits for reinvestment may vary depending on the financial performance and profitability of the company. Companies with lower profits may have limited resources for ploughing back into the business.

4.5 Practical implications

The study provides valuable insights for company management in determining the best and least expensive source of financing. The findings can inform strategic planning of the equity financing process and help optimize the capital structure. Furthermore, the study contributes to the existing literature by being the first to examine the combined or independent impact of angel investors, retained earnings, crowdfunding, and ploughed-back profit on the financial performance of Jordanian industrial companies. Policymakers can also

benefit from the study by formulating effective policies that promote equity financing and support the growth and success of Jordanian industrial companies. Furthermore, the study's findings can also serve as a valuable benchmark for companies in similar industries, allowing them to compare their profit-allocation strategies and financial performance with those of industry leaders. This can help identify areas for improvement and drive innovation in how companies allocate their profits to maximize financial stability and growth.

The findings of this study will provide valuable insights for managers and stakeholders in making strategic decisions related to profit allocation and equity financing. Additionally, stakeholders, such as investors and shareholders, can use the findings of this study to assess the financial health and stability of companies and make informed investment decisions. These practical implications highlight the importance of understanding the relationship between ploughed-back profits and financial performance in the decision-making processes of managers and stakeholders.

While this study contributes valuable insights into the impact of equity financing on financial performance, there are still opportunities for future research to enhance our understanding of this relationship further. For example, conducting industry-specific studies can help uncover how the impact of retained earnings varies across different sectors, considering industry dynamics and specific factors that influence the relationship. Additionally, exploring the role of management decisions and strategies in leveraging retained earnings for financial performance can guide companies on best practices. Longitudinal studies that track the financial performance of companies over time can also provide valuable insights into the long-term impact of retained earnings and help identify trends and patterns. By considering these avenues for future research, a more comprehensive understanding of the relationship between retained earnings and financial performance can be achieved.

5 Conclusion, Limitations, and Recommendations

In conclusion, the results of the hypothesis testing show that equity financing has a positive effect on financial performance. Additionally, the sub-hypotheses

testing results show that angel investors, retained earnings, crowdfunding, and ploughed-back profit positively impact financial performance.

5.1 Limitations

The study focused specifically on Jordanian industrial companies, and the findings may not be generalizable to other industries or countries. Therefore, it is possible to conduct new studies for different industries and consider other factors, whether internal variables (such as company size) or external economic variables (such as inflation). One limitation of this study is purposive sampling, which may introduce bias in selecting board director members.

Furthermore, while the descriptive data were collected using the questionnaire and analyzed by SPSS software, the data can be managed in other ways using different analysis methods. Another limitation is the reliance on self-reported data through the online questionnaire, which may be subject to response bias.

While crowdfunding has positively impacted financial performance, it is important to consider this funding source's potential drawbacks or limitations. One limitation of crowdfunding is the requirement for disclosure and registration, which can introduce additional administrative burdens and compliance costs for companies. Moreover, crowdfunding may also introduce liquidity risk, as it may require an active secondary market for crowdfunded shares in order for investors to liquidate their shares. This can result in shares being sold at a significant discount, potentially impacting the company's overall financial performance. Therefore, while crowdfunding can provide access to capital, companies must carefully consider the potential limitations and risks of this funding source.

5.2 Recommendations

While this study contributes valuable insights into the impact of equity financing on financial performance, there are still opportunities for future research to enhance our understanding of this relationship further. For example, conducting industry-specific studies can help uncover how the impact of retained earnings varies across different sectors, considering industry dynamics and specific factors that influence the

relationship. Additionally, exploring the role of management decisions and strategies in leveraging retained earnings for financial performance can guide companies on best practices. Longitudinal studies that track the financial performance of companies over time can also provide valuable insights into the long-term impact of retained earnings and help identify trends and patterns. By considering these avenues for future research, a more comprehensive understanding of the relationship between retained earnings and financial performance can be achieved.

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