The Effect of Corporate Governance on the Financial Performance of Listed Companies in Amman Stock Exchange (Jordan)

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***Abstract*—The purpose of this paper is to discuss the effect of corporate governance and financial performance for listed companies in Amman stock exchange; and to less degree to know what is element of corporate governance structure affect more on listed companies' financial performance. This paper is a descriptive research based on analysis of previous western; and Jordanian studies towards corporate governance for listed companies in Amman stock exchange (Jordan). It was concluded that that ownership structure has the highest effect on the financial performance of listed companies in Amman stock exchange. Moreover, the institutional ownership has better affect more than family ownership on the financial performance. The financial performance of listed companies from different sectors (banking, insurance and services) in Amman stock exchange is getting better after the application of corporate governance.**

***Index Terms*—Corporate Governance, securities market**

I. Introduction

The global economy has recently suffered many losses due to the financial crisis. As a result many companies bankrupted like Enron (2001) and WorldCom (2002). The managers who lack ethical values caused most of these collapses. They commit fraud to serve their own interests [1].

To protect companies and their stakeholders, the regulatory agencies tried to discourage unethical practices by imposing rules that prohibit these practices; one of the most important rules, Corporate Governance System [2].

Corporate Governance is a system by which business corporations are directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among different participants in the corporation, such as, board of directors, management, shareholders and external auditor. In relation to board of directors and management, the corporate governance provides the structure through which the objectives of the company can be set, and the means of meeting these objectives. In relation to shareholders, the corporate governance recognizes the rights of shareholders as stated by law, and encourage the cooperation between them and the company. In relation to external auditor, the well-governed companies facilitate auditors work, that is, if the company books are prepared according to the procedures set by the management, then the auditor can easily test these books and confirm if the company's financial statements are prepared in accordance with certain criteria [2]

Financial scandals in several countries have served as justification for new legislation to regulate corporate governance practices. For instance, the USA passed the Sarbanes- Oxley Act in 2002. In 2005 the Financial Reporting Council (FRC) in the UK updated the Turnbull Guidance on internal control to be consistent with internal control reporting requirements as set out in section 404 of the Sarbanes- Oxley Act and the related SEC rules [3].

The Asian financial crisis started in 1997, which deteriorate many of the East Asian companies' financial performance, caused mainly by the failure of these companies to govern their activities [3].

In Jordan, Securities and Exchange Commission had issued a code about corporate governance practices in 2007 to insure the importance of applying corporate governance by Jordanian companies, and to promote international best practice in governance [4].

The current study attempts to investigate the corporate governance practices in Jordanian companies listed in Amman stock exchange, and impact on its financial performance.

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II. Study Problem

The corporate governance and financial performance relationships are exposed to many factors that limit these relationships. The problem of the study can be summarized into the following questions:

1. Do listed companies in Amman stock exchange commit corporate governance practices?
2. What are the elements in corporate governance structure affect more on the financial performance of listed companies in Amman stock exchange?

III. Study Objectives

This study seeks to achieve the following objectives:

1. Identify the extent of applying corporate governance practices by listed companies in Amman stock exchange.
2. Examine the relationship between corporate governance practices and financial performance in JIC.

IV. Literature Review

A number of previous studies examining the relations between corporate governance and its effect on financial performance in different sectors. The following pages show most recent and important studies relevant to the current study.

To find out whether corporate governance affects the relationships between fundamental signals and stock returns in Taiwan, Shen and Lilin [5] applied switching model of 183 firms. The result suggest that stock returns indeed respond differently in deferent governance regimes in a strong governance responses of stock returns to the fundamental signal are found to be greater than those in weak governance regimes, there for the payoff to firms could be substantial if firms especially those emerging marked improve their governance future studies could also apply the same concept and to methodology to other countries to examine the hypothesis.

To find out whether principle-based corporate governance practices have a positive impact on large listed companies in New Zealand, Reddy et al [6] surveyed 340 (in total) largest New Zealand firms. They reported that large listed companies have universally adopted Securities Commission recommendations, which have a positive influence on firm's performance. The findings also provide indications that large companies have a good governance practices.

To examine the factors associated with the establishment of a risk management committee (RMC) in Australia and to examine whether the existence of a RMC is associated with board factors, such as the proportion of non-executive directors, Subramaniam et al [7] surveyed 300 of the top Australian stock exchange (ASX) listed companies. They reported that board leadership and board size are key elements in the establishment of RMCs, and highlight the significant roles played by board leadership and board size, as well as financial reporting risks and organizational complexity in the decision to set up and disclose separate RMC.

To explore relationship between different governance configurations and firm survival in Lebanon, Sreih [8], surveyed 116 family enterprises. “The objective is to describe the alternative mechanisms through which the owning family takes a stake in the governance of the firm". The governance systems of 116 family enterprises in Lebanon are examined. The study integrates family, ownership, leadership, and the business itself constituting the four structural elements of a family firm's governance system. The result showed that family relationship and leadership, business dimension have positive impact on the performance/survival of the firm.

To find out a comprehensive quantitative measure on the quality of the corporate governance and the ownership structure in non-financial listed companies in Malaysia, Ranjbar [9] surveyed 100 companies. The result represent that ownership appears to be quite concentrated at the level of the largest ultimate shareholder which our data showed that only 13% of companies are widely held and 87% of remaining are on the hand of major shareholders directly or through pyramiding. And size also has a significant positive effect on performance and dividend payment of company.

To find out the determinants of good governance in the US firms, Khanchel [10] surveyed a sample of 624 non-financial firms and US listed for the period of 1994-2003. Multiple regressions analysis is used in the study to find the determinants of strong governance. The result shows statistically significant and positive associations between each governance index and firm size, investment opportunities, intangible asset and directors and officer's ownership. And they provide evidence that higher managerial and institutional ownership enhances governance.

To find out the effects of corporate governance in financial services sectors in UK, Schachler et al [11] surveyed 3 service sectors. They examined the tensions which can be exist in different interest groups and by the need to balance responsible risk management against the imperative of making an economic return as part of successful economy. The authors concluded that the assets and liabilities in the balance sheet are mismatch, and recommended to keep lenders confidence and imply a wider duty of care for bank directors, external regulators and auditors. And also external auditors have additional responsibilities in connection with financial services clients, including reporting breaches of laws and regulations.

To find out the relationship between corporate governance and firm performance in USA, Brown and Caylor [12] surveyed 2,327 firms by examining 51 factors underlying Gov-Score that are most highly associated with firm performance. They find that better-governed firms are relatively more profitable, more valuable and pay out more cash to their shareholders. Through their examination for the 51 factors, they explain that good performance, as measured by executive and director compensation, is most highly associated with good performance, and when they measure it by

charter/bylaws they show that it is most highly associated with bad performance.

To find out the effect of corporate governance system on the Firm's performance in Japanese companies, Sakai and Asaoka [13] surveyed an unbalanced panel consisting of 478 Japanese firms. The aim of the study is to answer how corporate governance and market competition affect firm's performance. The result showed that R&D and human capital accumulation are complements, and that firm productivity will rise by effectively improving the structure for utilizing human capital. And not only market- based discipline- which is the feature of Anglo-American- type governance, but also debt- based discipline, which is one of the main characteristics of Japanese- type governance, still improves firm performance.

To examines the factors that determine whether a nations system of corporate governance works to maximize overall corporate value and protect the legitimate interests of non-controlling stakeholders, Megginson [14] defining the major components of an effective corporate governance system, and describe how these component can reinforce each other if designed effectively. And then surveys the various strands of academic literature that have contributed to today's sophisticated view of what constitutes an effective corporate governance system. The results reveals that while it’s impossible for a nation to change its entire system of corporate law- it’s within the grasp of most governments to reform existing laws to provide better protections for non- controlling investors.

Dwiri [15] investigated the effect of corporate governance on the firm’s market value, applied the study of listed firms in Amman stock exchange from 2009-2012, and found that the highest contribution of corporate governance principles was ownership structure, while the lowest one was audit firm’s size, and in general there was a positive relationship between the application of corporate governance principles and the market value of listed companies in Amman stock exchange. Shubita [16] investigated the impact of foreign ownership on non-financial public shareholding firms in Amman stock exchange for the period from 2000-2008, and examined the relationship between foreign ownership and firm growth opportunity, stock liquidity leverage, and firm performance; it was found that foreign ownership can provide improved corporate governance practices by playing positive role in increasing the growth opportunity and enhancing the firm’s market valuation, and found that firms with foreign board membership have higher firm value. Toumar [17] Investigated the relationship between corporate governance (namely: ownership structure, board composition, and board size), and bank performance by estimating a linear regression analysis. The results showed that ownership structure and board composition have a strong impact on the bank performance. Results indicated that banks with institutional majority ownership have the best performance, and that when both manager's and board members' ownership claims in bank's shares increase the bank's performance becomes more efficient. Surprisingly, the number of board of director members (board size) has no effect on bank's performance. Almanzoua [18] explored the effect of corporate governance on dividends policy; study found that there was an effect of corporate governance of the profits of companies represented in the assets and in distributing its profits; the study found also that Jordanian Companies have a good level of governance which is considered as a positive indicator of corporate governance.

AlJabree [19] investigated the effect of well-designed corporate governance on the financial stability of insurance companies listed in Amman stock exchange; it was found that there was a significant effect of corporate governance on the financial stability especially regarding financial leverage. Mohammad [20] Examined the relationship between financial slack and firm performance, and the influence of corporate governance (ownership structure) on this relationship. The relationship varies depending on the presence of different types of owners; family ownership negatively moderates the relationship between financial slack and firm’s performance whereas managerial ownership positively moderates the relationship. Kharabsheh [21] Explored investigated the relationship between good governance indicators and the financial performance in Jordanian commercial banks. The study found that there is a positive relationship between corporate governance and financial performance when measured by earning per share, price earnings ratio, also it was found that bank size do matter when studying the relationship between corporate governance and financial performance.

Al-beshtawi et al [22] conducted a study in order to indicate the role of corporate governance in the commercial banks and Islamic banks in Jordan and its impact on financial and non-financial performance because of its positive effects on the improvement and development in the process of managerial decision-making through various development and modernization in the processes and stages of internal activities of banks and raise the level of performance. The study sample included the society represented by all commercial banks and Islamic Jordan totaling (16 Jordanian Banks).Where the study aimed to executive management, sections and departments on the Application of Corporate Governance in those banks as well as financial and accounting departments where. The study found that commercial banks and Islamic banks in Jordan apply corporate governance through identified for its principles and its components and steps and provided specialized committees would activate the application of corporate governance. And recommended the need for greater attention to the competent authorities to monitor financial and non-financial performance of the departments of Jordanian banks and increase the provisions of the law and the necessary legislation imposed by the government and the competent application of corporate governance.

Based on a sample of 105 listed companies in the financial sector on Amman Stock Exchange market over the period 2011 to 2013, Zayed [23] investigated the

relationship between several attributes of corporate governance namely: board size, duality CEO, board experience, board independence, audit committee and managerial ownership, and financial firm performance. The results showed that ownership structure and board composition have a strong impact on the financial companies' performance. Results indicated that financial firm performance with board independence has the highest performance and that as board size and board expertise increase the financial firm performance becomes more efficient. Furthermore, managerial ownership percentage has negative effect on financial firm performance.

Shanikat and Abbadi [24] assessed the reality of corporate governance in Jordan. Study identified the framework of corporate governance, which has here been set into two dimensions, institutionalizations and regulations, and described the five major principles of corporate governance. The study was carried out by interviews with key employees and the review of related laws and selected annual reports. The study found basic shareholder rights were honoured in decision-making, except for large decisions such as major asset sales; shareholders were not treated equitably in practice, although controllers sometimes took action and prohibited insider trading; the role and rights of stakeholders in corporate governance were respected, and stakeholders had a number of legal protections, which were largely covered in Jordan's Company Law; disclosure and transparency were observed to a large extent, although limited to quantity rather than quality, because Jordan has fully adopted IFRS and ISA and boards largely fulfilled their responsibilities, as these are extensively defined by law and regulation

Al-najjar [25] investigated the relationship between ownership structure and corporate governance, namely the factors that determine institutional investors' investment decisions in emerging markets using Jordanian data. This study highlighted the importance of the institutional investors as the main owners of Jordanian firms, to the legislative authorities to enhance the corporate governance decisions in Jordan. The results showed that the Jordanian institutional investors consider firms' capital structure, profitability, business risk, asset structure, asset liquidity, growth rates, and firm size when they take their investment decisions. In addition, institutional investors in Jordan prefer to invest in services firms rather than manufacturing firms. Furthermore, the study cannot find any significant relationship between firms' dividend policy and institutional investors.

Zeitun and Tian [26] examined the impact of ownership structure on firm performance and the default risk of a sample of publicly listed firms. The main findings were: ownership structure has significant effects on the accounting measure of performance return on assets (ROE); government shares are significantly negatively related to the firm's performance ROE; defaulted firms have a high concentration ownership compared with non-defaulted firms and also high foreign ownership firms have a low incidence of default; government ownership is significantly negatively related to the firm's probability of default; both mix and concentration ownership structure data can be used to predict the probability of default as the largest five shareholders (C5) and government ownership fraction (FGO) are significantly negatively correlated with the probability of the default. These results further suggest that reducing government ownership can increase a firm's performance but will also cause some firms to go bankrupt, at least in the short term.

Al-Khouri [27] empirically explored the relationship between the identity and concentration of different block holders and firm value for 89 industrial and service firms listed at the Amman Stock Exchange (ASE) over the period 1998–2001. The paper examined the role of block holders (institutional investors who are not on the board of directors, the institutional investors who are on the board of directors, the ownership of the board of directors, and the financial policy of the firm, such as the capital structure) in controlling the managerial actions which leads, on average, to better firm valuation in the emerging market of Jordan. The results showed a significant and positive relationship between the ownership of the board of directors and firm value. Also, found a positive and significant relationship between firm value and ownership by institutional investors whether or not they are on the board of directors. However, there is no significant relationship between ownership by management and firm value.

Al-manaseer et al [28] investigated empirically the impact of corporate governance dimensions (Board Size, Board Composition, Chief Executive Officer (CEO) Status, and Foreign Ownership) on the performance of Jordanian Banks. The study reveals a positive relationship between corporate governance dimensions: the number of outside board members and foreign ownership and Jordanian banks' performance. Whereas, board size and the separation of the role of CEO and chairman have a negative relationship with performance. In addition, the study revealed that banks benefit from large size in offering services more than granting loans.

Almajali et al [29] aimed at investigating the factors that mostly affect financial performance of Jordanian Insurance Companies. The study population consisted of all insurance companies' enlisted at Amman stock Exchange during the period (2002-2007) which count (25) insurance company. The data collected was analyzed by using a number of basic statistical techniques such as T-test and Multiple- regression. The results showed that the following variables (Leverage, liquidity, Size, Management competence index) have a positive statistical effect on the financial performance of Jordanian Insurance Companies.

V. Conclusion

Based on previous literatures that were conducted in Jordanian market, on listed companies in Amman stock exchange, it was concluded that:

1. Ownership structure has the highest effect on the financial performance of listed companies in Amman stock exchange.
2. The institutional ownership has better affect more than family ownership on the financial performance.
3. The financial performance of listed companies from different sectors (banking, insurance and services) in Amman stock exchange is getting better after the application of corporate governance.
4. There is a positive relationship between financial performance and foreign ownership in banking sector.

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