



IMPACT OF CORPORATE GOVERNANCE ON FINANCIAL INSTITUTIONS' PERFORMANCE: A BOARD COMPOSITION CASE



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ABSTRACT

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The impact and implementation of Corporate Governance (CG) has been a matter of interest for various firms, as it substantially affects the financial stability of institutions. This study analyses the impact of Corporate Governance (CG) elements that include board composition on the financial performances of the financial institutions listed on Jordan's Amman Stock Exchange (ASE). The study population involved 40 Jordanian financial institutions belonging to both commercial banks and financial companies listed on the Amman Stock exchange (ASE). Spearman correlation was used to identify the relationship between corporate governance and financial performance of institutions. It showed an insignificant correlation between board composition in general and companies' financial performance. In the relationship between each board composition factor to each financial performance measure, the study found positive, negative, and mixed correlation results. While analyzing the institution's performance, any prospective researcher should consider other CG factors so that the study could better represent the CG impact on institutions' performance in developing countries such as Jordan.

Contribution/ Originality: This study contributes to the existing literature on the impact of corporate governance on firm performance. Although previous studies have assessed this research area, most studies are centered on the developed countries and large economies, with little to no focus on developing and small economies like Jordan.

1. INTRODUCTION

Corporate governance has been one of the main research interests in the world of social sciences for over twenty years (Christofi *et al.*, 2012). Bawaneh and Badran (2015) defined corporate governance as a set of relationships between stakeholders and the management of any company. It is used as an instrument for rapid economic growth and functions to attain valuable transparency and business collectivity. Many historical events related to the financial sector are responsible for providing greater interest to the idea of corporate governance as the major part was played during the financial crisis that took place in Brazil, Asia, and Russia in 1998 (Claessens and Yurtoglu, 2012). Various economies were affected due to the inefficient role of the corporate sector, while lacking in the system of corporate governance has substantially impacted the financial stability of the institutions. The crisis emphasized the role of corporate governance in providing significant advantages to economic development and social wellbeing.

With the emerging changes in the financial sector and market-based investments, the role of corporate governance serves as an increasing step for the welfare of the financial institutions. Since the capital markets of the present world are going through complex functioning due to increased competition. Globalization, mobilization of capital, and other factors forced countries to set effective corporate governance standards (Bhasin, 2016). The idea, however, is crucial in identifying the need for good corporate governance.

In the last decade or so, the terminology of corporate governance became more significant and controversial, particularly in the developed countries, due to many failures such as accounts of fraud, accounting scandals, and other failures of the governance in many companies such as Enron which is an example of an ineffective internal control that resulted in financial failure (Carroll, 2015). The board of directors serves as the essential ingredient of corporate governance and thus serves as the heart of many structures and financial systems. Similarly, the board serves as an important constituent in decision and policy-making processes. The area has gained significant criticism and was considered responsible for the rapid decline in shareholders' wealth along with corporate failure (Jizi, 2017).

Furthermore, corporate governance serves as an important aspect of dealing with different ways where finance suppliers expect to gain greater returns on investments. The idea is further illustrated through agency theory, according to which the independent functioning of managers may provide greater interest in attaining high-level investments and financing (Samaduzzaman *et al.*, 2015). This creates conflicts between the role of managers and shareholders, which can be resolved through continuous monitoring of block holders and board of directors, investments in managerial equity along with the compensatory contracts.

Corporate governance further helps in providing financial growth to banks, an idea that attracts the interest of various politicians and academicians. Efficient corporate governance is fruitful for improvised public accountability, value creation, maximum efficiency of various operations, and minimum exposure to risk. Various regulators and shareholders are now pinpointing that corporate governance plays a substantial role in improving firms' performances. Shareholders expect value creation in money that is being paid to board members, provide minimum failures to regulators, and higher stability (Salim *et al.*, 2016).

The financial frauds in many corporations such as Enron, World Com and others increased the demand for studies related to the impact of corporate governance on the companies' financial performance as well as the motivation for the research about the solution to eradicate all types of financial scandals adversely affecting firms' performance (Bhasin, 2016; Bhasin, 2016). However, most of this work has been focused on developed countries. Although the research on corporate governance and firm performance is not new, the issues have generally been observed for developed economies with few studies focused on the developing countries (Love and Rachinsky, 2015; Arora and Sharma, 2016).

In developing countries such as Jordan, few empirical studies are conducted in terms of examining the impact of corporate governance on firm performance. The deficit in the research may account for the relatively opaque disclosure practices of the company or lack of data availability. The findings of developed countries concerning corporate governance's impact on financial performance do not apply to Jordan due to its significantly smaller firm size as compared to those in developed countries, and also as most firms are regulated as family businesses (Abbadi *et al.*, 2016). The few studies that have been conducted in Jordan were either focused on the family financial firms (Saidat *et al.*, 2019) or companies listed on a particular stock exchange (Mansur and Tangl, 2018). It lacks an examination of the impact of corporate governance, especially board composition on financial institutions' performance (Al Daoud *et al.*, 2015; Abbadi *et al.*, 2016; Al-Momani and Almomni, 2018). To bridge this gap, the study has formulated the following research question;

“Is there any significant relationship between corporate governance components such as the board composition and the financial performance of the financial institutions listed in ASE in Jordan?”

Understanding the impact of corporate governance on firm performance is important to examine the relationship between corporate governance variables such as board size, number of independent directors, chairman duality and number of board meetings, and financial performance variables such as return on assets (ROA), earnings per share (EPS), and return on investment of financial institutions in the Jordanian context based on past related studies. The significance of the study lies in the fact that it provides detailed knowledge about the role of given variables in affecting the performance value of firms. Various academics, policymakers, and individuals working in the business sector can benefit from the study through the provided knowledge. The financial performances of various firms can be improved through a better regulatory mechanism, particularly in the context of emerging economies such as Jordan.

2. LITERATURE REVIEW

After the act of Sarbanes-Oxley, the idea of corporate governance and its components has gained significant attention. Dah and Hurst (2016) illustrated the importance of inside directors as creating a valuable impact on the firm's performance. Since insiders have access to inside information on the firm, this facilitates the process of decision-making regarding firm operations. The addition of independent directors during board composition ensures a certain probability to increase the costs that are related to the coordination and problems of free riders. The idea is studied under the framework of the Sarbanes-Oxley Act (SOX) of 2002 that has provided a greater impact over the mechanism of corporate governance and financial controls. The findings showed that independent directors and their participation have significantly increased after SOX. This increase was the result of the increase in liberty provided at the expense of grey directors and insiders. It illustrated a negative relationship between the change in board composition and firm's performance.

Mahtab and Abdullah (2016), by interviewing forty board of directors and employees, illustrated that an efficient system of corporate governance generally helps in mobilizing the capital. This demands efficient use of assets and resources within and outside the company. The effective mobility of funds enhances the probability of providing greater returns. A theoretical analysis reveals that the role of corporate governance is crucial for attaining long-term competitiveness (Baumgartner and Rauter, 2017). Besides this, Hutchinson *et al.* (2015)'s survey of Australian firms from 2006 to 2008 depicted that good corporate governance increases the chances of attracting greater investments. The study further indicated a positive relationship between corporate governance and ROE. The investigation of the study was related to the examination of the mechanism of corporate governance by the given variables; independent board directors, board size, board audit, and the duality of CEO. The paper further indicated that good corporate governance creates a significantly positive impact on increasing the rate of GDP.

Azeem and Kouser (2013) studied the relationship between a firm's performance and corporate governance by considering important variables such as capital structure, firm size, accounting standards, and financial crisis. The study indicated a positive relationship between corporate governance and firms' performances. Formulation of better policies and changes in the previous structures of corporate governance promotes high scale firms' performances. A similar idea was studied by investigating firms' performances through the impact of board composition. The findings proposed similar results, as illustrated by Rashid *et al.* (2010) on 274 Bangladeshi, providing a negative relationship between independent board directors and firms' performances. Rouf (2011), using the OLS method for the financial firms in Bangladesh, also depicted similar results.

In addition, Moscu (2013) studied different concepts related to the duality of the CEO and its' influence over firms' performances. Evidence provided in the given study indicated that the present world promotes non-dual CEO leadership in most financial institutions as dual leadership creates a negative impact on the expenses of the company and its shareholders.

However some studies, contradict this idea. Haldar *et al.* (2016), examining 36 pharmaceutical companies in India, illustrated the positive relationship between dual leadership and firms' performances. Chi *et al.* (2015)'s study on 379 listed high-technology Taiwan firms showed that dual CEO leadership usually creates institutional ownership and financial leverage, which is important in minimizing the problems of financial institutions.

Bawaneh (2011) examined the impact of corporate governance requirements released by professional bodies on the banking sector in Jordan and found that banks in Jordan comply with these requirements. Significant attention is being provided towards corporate governance concerning the banking sector of Jordan. To efficiently regulate the mechanism of corporate governance Bank Directors Handbook (BDH) was issued by the Central Bank of Jordan (Tomar and Bino, 2012). The government of Jordan is actively engaged in providing certain restrictions related to the bank policies and its' regulatory system.

Qaiser (2011) studied the role of corporate governance through different variables, including (board size, board composition, and audit committee). The results of the study provided a positive relationship between ROE and the given mechanism of corporate governance (Qian and Yeung, 2015). However, the study failed to prove any significant relationship between the duality of CEO and performance measures.

Htay (2012) studied different effects of corporate governance on the profitability of banks and found the board's independence and institutional ownership adversely and significantly affects ROE. Rostami *et al.* (2016) study on 469 firm observations in Tehran using generalized least square method showed that board independence, ownership concentration, CEO tenure, CEO duality, and ROA are all substantially related to each other. Salim *et al.* (2016) study on Australian firms using two-stage double-bootstrap data envelopment analysis showed that the financial performance improves as a result of increased board size as well as committee meetings. The study results of Shahwan (2015) contradicts these findings. The research was conducted in Egypt, constructed a corporate governance index (CGI) and analyzed 86 non-financial firms, and showed no relationship of quality of corporate governance with financial performance.

Sumaira (2012) study illustrated that corporate governance creates a positive impact over Pakistani firms in providing maximum growth and development to organizations. The same results were obtained by the study of Arora and Sharma (2016) on India, which showed that increased board size was linked to improved decision making, resulting in improved financial performance.

Al-Manaseer *et al.* (2012) studied the effects of the management board size, management board structure, CEO duality, and the foreign ownership on the performance of the Jordanian banks and found a positive relationship between the number of members of the board of directors and the foreign ownership with the performance of the Jordanian banks and showed a negative relationship between the size of the board of directors and CEO duality with the performance of the Jordanian banks. Qadorah and Fadzil (2018) study on the Jordan listed firms on the Amman Stock Exchange, showed that corporate governance is incremental in improving performance and mitigating agency conflicts.

Mousa and Al Manaseer (2012) examined the role of corporate governance dimensions on the performance of Jordanian banks and found a positive relationship between and Jordanian banks' performances and corporate governance dimensions whereas, board size and CEO duality had a negative relationship with performance. Mohammed (2012) conducted a study on the impact of corporate governance on bank performance among banks in Nigeria and illustrated a positive impact of corporate governance over bank performances. Aggarwal (2013) examined the role of corporate governance in creating a positive impact on the financial performance of the organizations. The relationship was studied in the framework of Indian firms while indicating a positive relationship between the given variables. Azzoz and Khamees (2016) examined the relationship between corporate governance and earnings quality and shown a positive relationship between the size of the audit board and earnings management. Al-Rahahleh (2017) also conducted a study in Jordan and investigated the impact of the Jordanian firm's dividend policy concerning the board gender diversity, and quality. The firms listed on the Amman Stock

Exchange (ASE) from 2009-2015 were included. The study results showed that corporate governance quality, as well as diversity, has a positive effect on the corporate dividend policy. Saidat *et al.* (2019) study on family and nonfamily firms in Jordan showed that corporate governance mechanisms substantially impact the family firms' performance.

3. METHODOLOGY

This research used many techniques such as document analysis and archival records produced and reported by both the financial institutions and the professional bodies from 2013 to 2017 in Jordan to gather more evidence on the impact of corporate governance elements especially the board composition on the financial institutions' performance. Based on the research question presented earlier, this research examined the relationship between different elements of corporate governance, such as board composition, to the financial performance of the financial institutions in Jordan. Therefore, the sample for this study consists of 40 Jordanian financial institutions, which include both commercial banks and financial companies listed in the Amman Stock Exchange (ASE) for the five-year period from 2013 to 2017. To examine the relationship, corporate governance elements such as board composition, board size, number of independent directors and board meeting, CEO duality, and three financial performance variables: ROA, EPS, and Return on Equity (ROE) are taken as financial performance variables of financial institutions listed on the ASE in Jordan.

The instrument for measuring this two-set of variables has been developed and independently tested in the past related studies, as shown in the literature review section. This study differs from other Jordanian studies by adding new variables related to both the board composition and the financial performance variables. The study selected more variables to be included with the board composition elements such as the number of board meetings and the number of independent directors and one additional variable such as EPS to be included in financial performance variables.

4. RESULTS AND DISCUSSION

Due to the problems of linearity, a non-parametric test was applied to analyze the relationship between the variables under analysis in this study. By using the SPSS package, the Spearman rank correlation shows the relationship between board composition variables and financial performance variables of the financial institutions listed on the ASE in Jordan.

Descriptive statistics of board compositions presented in Table 1 show a Skewness of -4.482 (standard value of the normal distribution is "0") and the Kurtosis of 22.432 (standard value of the normal distribution is "3") which means that the data does not follow a normal distribution. The results further illustrate that board size has a Skewness of 0.205 and Kurtosis of 0.263, which means that the data is distributed at approximately normal scales. The number of independent directors has a Skewness of the data that is -0.267, and a Kurtosis of -0.587, which means that the data is approximately normally distributed. Table 1 further shows that the CEO duality's Skewness of the data is -0.038, and the Kurtosis is -2.087 which means that the data is approximately normally distributed. The number of board meetings' Skewness of the data is 0.556, and the Kurtosis is -0.389 which means that the data is approximately normally distributed.

The descriptive statistics of financial performance as dependent variables presented in Table 1 below shows that ROA has Skewness of -6.593 (standard value of normal distribution is "0") and Kurtosis of 48.798 (standard value of normal distribution is "3"), which means that the data does not follow a normal distribution. It further shows that the EPS have a Skewness of 1.792 and Kurtosis of 4.318, which means that the data does not follow a normal distribution. In regards to the ROE, Skewness of the data is -1.787, and the Kurtosis is 25.373, which means that the data is not normally distributed.

Table-1. Statistics of board compositions and financial performance.

Statistical parameter	Board composition	Size of the board	Independent directors' numbers	CEO duality	Number of board meeting	ROA	EPS	ROE
Skewness	-4.482	.205	-.267	-.038	.556	-6.593	1.792	-1.787
Kurtosis	22.432	.263	-.587	-2.087	-.389	48.793	4.318	25.373

This research has applied the Spearman correlation coefficient test to analyze the correlation between the board composition (independent variable) and the financial performance (dependent variable) and found the following results. Table 2 shows the relationship between the board composition and ROA, EPS, and ROE, respectively.

The relationship between the board composition and ROA and shows that the significance level is 0.091 (standard level is 0.05), which means that there is no significant relationship of the board composition to ROA. The table also presents the relationship between board composition and the EPS and shows that the significance level is 0.854, which means that there is no significant relationship of the board composition to EPS of the companies. The relationship between the board composition and the ROE has a significance level of 0.081, which means that there is no significant relationship of the board composition to ROE.

The study found that there is no significant relationship between board composition and the financial performance variables and that it does not necessarily improve performance. This complies with the results of studies proposed by Rostami *et al.* (2016).

Table-2. Spearman's rho of board composition with ROA, EPS and ROE.

Board composition	Variables	Correlation coefficient	P-value
	ROA	.244	.091
	EPS	.027	.854
	ROE	.249	.081

Table 3 shows the relationship between board size and ROA, EPS, and ROE, respectively. The relationship between board size and ROA shows that the significance level is 0.344, which means that there is no significant relationship of the board size to ROA. The relationship between the board size and EPS shows a significance level of 0.001 value, which means that there is a significant relationship of the board size to EPS. The relationship between the board size and ROE has a significant level of 0.078, which means that there is no significant relationship of the board size to ROE. The study found no significant relationship of the board size to the financial performance variables ROA and ROE and a significant relationship of the board size to the EPS, where other studies such as Al-Manaseer *et al.* (2012); Dwivedi and Jain (2005) found a negative relationship with performance.

Table-3. Spearman correlation of board size to ROA, EPS and ROE.

Board size	Variables	Coefficient correlation	P-value
	ROA	-1.38	.344
	EPS	.454**	.001
	ROE	-.255	.078

** Correlation is significant at the 0.01 level (2-tailed).

Table 4 shows the relationship between the number of independent directors and ROA, EPS, and ROE, respectively. The relationship between the number of independent directors and the ROA has a significance level is 0.770, which means that there is no significant relationship of a number of independent directors to ROA. The relationship between the number of independent directors and EPS has a significance level of 0.001, which means that there is a significant relationship between the number of independent directors and EPS. The relationship between ROE and the number of independent directors has a significance level is 0.650, which means that there is no significant relationship between the number of independent directors and ROE.

The study found no significant relationship between the number of independent directors to the financial performance variables ROA and ROE, and a significant relationship between the number of independent directors and EPS where other studies such as Htay (2012); Sumaira (2012) and Terjesen *et al.* (2016) found a negative impact on financial performance.

Table-4. Spearman correlation of a number of independent directors to ROA, EPS and ROE.

Number of independent directors	Variables	Coefficient correlation	P-value
	ROA	.045	.770
	EPS	.466**	.001
	ROE	-.066	.650

** . Correlation is significant at the 0.01 level (2-tailed).

Table 5 shows the relationship between CEO duality and ROA, EPS, and ROE, respectively. The relationship between CEO duality and ROA shows a significance level of 0.005, which means that there is a significant negative relationship between CEO duality and ROA. However, the relationship between CEO duality and EPS has a significance level of 0.887, which means that there is no significant relationship of CEO duality to EPS. Table 5 also shows that the relationship between CEO duality and ROE has a significance level of 0.010, which means a significant negative relationship between CEO duality and ROE.

The study found a significant negative relationship of CEO duality to the financial performance variables ROA and ROE and no significant relationship with EPS, which complies with previous studies such as Al-Manaseer *et al.* (2012); Moscu (2013) and Mousa and Al Manaseer (2012).

Table-5. Spearman correlation of CEO duality to ROA, EPS and ROE.

CEO duality	Variables	Coefficient correlation	P-value
	ROA	-.389**	.005
	EPS	.021	.887
	ROE	-.355*	.010

** . Correlation is significant at the 0.01 level (2-tailed).

* . Correlation is significant at the 0.05 level (2-tailed).

Table 6 shows the relationship between ROA and the number of board meetings, EPS, and ROE, respectively. As shown below, the relationship between the number of board meetings and ROA has a significance level of 0.059, showing no significant relationship of the number of board meetings and ROA. The relationship between the number of board meetings and EPS has a significance level of 0.626 which means that there is no significant relationship between the number of board meetings and EPS. The relationship between the number of board meetings and ROE has a significance level of 0.020, which means a significant negative relationship between the number of board meetings and ROE. The study found no significant relationship between the number of board meetings to the financial performance variables ROA and EPS, and a significant negative relationship with ROE.

Table-6. Spearman correlation of number of board meeting to ROA, EPS and ROE.

Number of board meeting	Variables	Coefficient correlation	P-value
	ROA	-.278	.059
	EPS	.065	.626
	ROE	-.361*	.020

* . Correlation is significant at the 0.05 level (2-tailed).

5. CONCLUSION

This research examined and analyzed the correlation of corporate governance elements such as the board compositions to the financial performance of the financial institutions listed in ASE in Jordan. The Spearman rank coefficient test was used to examine the relationship of corporate governance elements with the financial performance of the financial institutions in terms of ROA, EPS, and ROE in order to measure the impact of corporate governance elements such as board composition to the financial performance of these institutions.

The study found no significant relationship between board composition and ROA, EPS, and ROE.

The study found that the relationship of the board size to the company's EPS was significant, and other company's financial performance measures do not show any significant relationship with the board size, which means that bigger board sizes help companies to enhance ESO.

The study found no significant relationship between the number of independent directors to both ROA and ROE. The study found a significant positive relationship of the number of independent directors to EPS, which means that if the number of independent directors increases, the company's EPS increases.

The study shows no significant relationship of CEO duality to EPS. But ROA and ROE, show a significant negative relationship to CEO duality, which means the company's ROA and ROE decreases with CEO duality. Therefore, companies should separate the role of a chairman from the CEO's role. This study found no significant relationship of the number of independent directors to ROA and EPS.

The study results contradict the previous studies and literature. This may be due to the mixing of both commercial banks and financial companies to be included in this study as one group. This study used board composition as the only element of corporate governance and neglected other variables of corporate governance. Future researchers should consider other corporate governance factors so that future studies could better examine corporate governance impact on institutions' performance in developing countries such as Jordan.

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