BOARD CHARACTERISTICS IN JORDAN INSTITUTIONAL BACKGROUND AND LITERATURE REVIEW

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ABSTRACT

The present study is a conceptual paper aims to investigate the effects of board characteristics on the performance of Jordanian firms listed on Amman Stock Exchange. The board characteristics as a part of corporate governance have become a major concern for all stakeholders due to the serious implications on the companies' operations including performance. This study could provide insight for those stakeholders to make a sound decision. Few studies have attempt to examine the board characteristics worldwide, however, Jordan as an emerging market lack of those very rigorous studies that can develop a comprehensive model to study the influence of board characteristics on the firm performance. Therefore, the study tries to draw some highlights on trend of recent literature review in the area. Jordan context of board characteristics and related empirical research are discussed here to show the importance of this mechanism to the development of the stock market of the country and protection of the investors. Passing through various developments in the field, however, the introduction of mandatory corporate governance principles was the hallmarks of such developments. Empirical research in the context of board characteristics is still at its infancy stage due to the recent mandatory introduction of corporate governance guiltiness. The present research provides some avenues to develop the literature in the area of board characteristics for the context of Jordan. This may provide some guidelines for the research to proceed with the examination of the board characteristics practices and its impact of the performance.

Keywords: Board Characteristics, Firm Performance, Board of Directors, Amman Stock Exchange, Jordan

INTRODUCTION

The board of directors has been acknowledged as a crucial tool of corporate governance that can balance the management and stakeholders' interests. One premise is that the adoption of corporate governance mechanisms for such a purpose (aligning interests) was motivated by both the agency problem and the free-rider problem that prevents the investor/stakeholder from affording the monitoring costs (Sanda, Garba & Mikailu, 2011). In the context of Jordan, the Jordanian Corporate Governance Code dictates that Jordanian companies are mandated to employ the best corporate governance practices to guarantee superior oversight. In this sense, the board of directors is the core institution of a firm's internal governance and characteristics of corporate governance are deemed to be the means by which to resolve various categories of problems related to the agency phenomenon. The board of directors plays a key role in the companies' governance and is responsible for overseeing the information quality in the financial

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reporting. Additionally, they control senior manager's behavior to guarantee that their activities are aligned with the interests of stakeholders (*i.e.*, investors, shareholders and debtors) (Dimitropoulos & Asteriou, 2010). According to Fama & Jensen (1983), the existence of independent directors on the board facilitates the independence of the board from management as it distinguishes management from control functions. Also, independent directors can tackle 69 issues that arise between internal managers, or those between internal managers and residual claimants. In this regard, Che Haat, et al., (2008) show that an effective board is a significant characteristic of internal governance that assists in resolving the company's agency issues. Board characteristics are important factors for the timeliness of a company's annual report (Abdelsalam & Street, 2007; Chiang, 2005; Wu & Liu, 2008; McGee & Yuan, 2012).

The literature reveals that the existence of an effective corporate governance system ensures overseeing of management. It reduces the likelihoods of mismanagement and misreporting, (Dimitropoulos & Asteriou, 2010). Darwazeh & Dabaghia (2018); Shukeri & Nelson (2011) assured that the agency conflicts may be caused by the agency relationship among managers and shareholders. Effective corporate governance is presumed to reduce such problems. The existence of corporate governance mechanisms may reduce the audit labor and time required to complete the audit. Afify (2009) shows that effective corporate governance improves control and management of processes and reduces business errors. This leads to a shorter reporting time.

BOARD CHARACTERISTICS IN JORDAN

In the context of Jordan, the global crises which have affected firms around the world have made the stakeholders in Jordan to have a rethink in respect of credibility of the financial reporting of listed companies in Jordan (Hamdan, 2012). Various efforts were put in place to enhance the financial environment of the country. Moreover, the financial sector regulations were reinforced by issuing different laws and the Corporate Governance Code. The reinforcement of the regulations has led to an increase in the number of companies listed in ASE from 161 in 2000 to 247 by 2013 (Marashdeh, 2014). In addition, the economy of Jordan has demonstrates development, witnessed by growing volume of trade and market capitalization, which translated into a significant upsurge in the number of firms listed on Amman Stock Exchange (ASE) (ASE, 2012). This reflects the advanced economic liberalization, corporate governance reforms and encouragement of foreign investment enacted by the Jordanian government since the late 1990s.

The Jordanian Code of Corporate Governance issued in 2009 has defined the independent members as "a member of the board of directors who is not tied to the company or any of its upper executive management, affiliate companies, or its external auditors. This can be through any financial interests or relationships other than his shareholding in the firm that may be suspected to bring that member benefit, whether financial or incorporeal, or that may affect his/ her decisions or lead to the exploitation of his/ her position with the firm" (JSC, 2009). Amman Stock Exchange policy stated that board of directors of Jordanian listed firms must include the independent members to assure the availability of objective decisions.

Those independent members contribute in ensuring the balancing of the influences of all the parties, including the principal shareholders and the executive management, to making sure that the decisions taken are consistent with firm interest (ASE, 2009; CJB, 2010). Moreover, Gompers, Ishii & Metrick (2003) provided evidence of a positive relationship among corporate governance and company performance, and such relationship may contribute in the agency explanations. In Jordan also, Sharar (2007) has recommended that the Jordanian restriction requiring directors to own a certain number of shares to engage for board membership should be

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removed. This step would encourage the independent technical and professional expertise on boards rather than the current situation of boards of directors being dominated by the controlling family in Jordan. And in Jordan; the country's listed firms are required to include the independent members. This is to ensure that there are objective decisions available. These independent members are instrumental in making sure the influences of all involved parties are balanced. Such parties include the principal shareholders and the executive management and they contribute to ensuring that the decisions made are in line with the firm's interest (ASE, 2007; CJB, 2010) which will ultimately positively affect the performance of the firm.

In addition, to enhance strong corporate governance, Jordanian Securities Commission, (JSC), in 2009, issued the Corporate Governance Code governing the Shareholding Companies Listed on the Amman Stock Exchange which defines and stresses on the responsibilities and formation of the board, its committees and their monitoring roles over the management. Specifically, the code defines the responsibilities of the board of directors as (1) setting strategies, policies, plans and procedures that realize the objectives of the company; (2) taking necessary measures to ensure compliance with the laws in force; (3) setting a risk management policy to address the risks that the company may face; (4) setting procedures that forbid insiders in the company from using inside information to achieve material or moral gains; (5) taking necessary steps to ensure internal supervision on the company's work in progress, including ensuring compliance with the laws in force; (6) reviewing and evaluating the performance of the company's executive management; (7) adopting criteria for granting incentives, compensations, and privileges to members of the board of directors and executive management; and (8) setting a policy to organize relations with stakeholders in a manner that ensures fulfillment of the company's commitments toward them, safeguards their rights, provides them with adequate information, and maintains good relations with them (JSC, 2009).

Moreover, corporate governance code also describes the committees formed by the board of directors such as audit committee. JSC (2009) stipulates that the members of audit committee must have knowledge in finance or accounting, and at least one of them must have worked previously in accounting or finance fields; and that person must have an academic or professional certificate in accounting, finance or related fields. Also, this code ensures audit committee periodically meet and at least one meeting with external auditor must be held.

LITERATURE REVIEW AND THE EMPIRICAL GAP

It is undeniable that since 1978 a substantial number of empirical researches on board of directors and firm performance have emerged. However, the bulk of the published research on frim performance relationship was done in the context of developed countries. Variations in the governance mechanisms and arrangements are determined by the differences in firm characteristics and countries. For example, in the U.S. system, discrete shareholders play a significant role, and the primary agency conflict is between owners and managers. Under this system, a significant risk to shareholders is fraudulent financial reporting. Hence, the existing corporate governance mechanisms are tailored to alleviate these agency conflicts (Carcello, Hermanson & Ye, 2011; Shawtari et al., 2015). Specifically, little evidence is provided in the Middle East in general and Jordan in particular (Marashdeh, 2014).

As this study sheds light on the Jordanian context as one of the developing countries that has received little interest by researchers to examine such a relationship, given the differences that exist between developed and developing countries, such as that the concentration of ownership is higher in developing countries and that most companies are also family-owned. In addition to the duality of roles between the CEO and the Chairman of the Board of Directors, and other differences that were serve as a motivation for conducting this study.

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In the same vein, firm performance in Jordan is low, and has led to decrease in the level of financial reporting quality, loss of the financial statements' reputation, and it consequently jeopardizes the confidence of shareholders and investors in the shareholding firms (Al-Sraheen, 2014). This has consequently attracted the concerns of the stakeholders (Almajali, Alamro & Al-Soub, 2012; Shawtari et al., 2017). Conversely, in some parts of the world, the scenario may be different from what it is in the US due to certain factors relating to culture, legality, and regulatory traditions etc. As a result of this, the corporate governance mechanisms developed in an Anglo-American context may not fit well in the context of developing countries such as Jordan (Carcello, Hermanson & Ye, 2011).

The current crisis in the global financial enhances the importance of board of directors as a part of corporate governance in resolving global financial crisis (Siddiqui, 2014). This implies that inquiry regarding the benefits of good governance for the modern firms, and relationship between board of directors and firm performance becomes demanding (Siddiqui, 2014). The weak of firm performance of Jordanian-listed firms is attributed to weakness in board of directors. Abdullatif & Al-Khadash (2010); Ajeela & Hamdan (2011); Bawaneh (2011) confirmed these findings. Nimer, Warrad & Khuraisat (2012) show that the work as well as the weak independence of the members. Their results also indicate that the majority members of audit committees often have close relationships with firm management and the board of directors.

Abed, Al-Badainah & Serdaneh (2012) show that there is a weakness in the monitoring function of the board of directors of Jordanian firms. They attribute this weakness to the existence of more than 14 members on the board and the dual roles of CEO/chairman. These practices are not consistent with the Corporate Governance Code issued by ASE, which recommends that members of a board should not exceed 13 and that the roles of CEO and chairman role should be separated. This means that many Jordanian companies do not comply with ASE-issued corporate governance instructions ASE, Thus, shareholders and investors in Jordan may face increased business risks because of poor implementation of corporate governance systems, weak control systems and non-existent or unclear corporate strategies and objectives (Abdullatif & Al-Khadash, 2010). Further, an efficient board is capable to enhance corporate governance. This is because efficient board could decrease the agency costs and overcome the conflicts that arise between the management and shareholders in Jordan, (ROSC, 2004).

In addition, low-level of firm performance in Jordan has made many firms liquidate and then collapse. According to the Companies Control Department (CCD), the statistics showed that from 2000 to 2011, there were 44 bankruptcy cases in Jordanian companies. 26 companies (59%) were from the industrial sector, 15 companies (34%) from services sector and 3 companies (7%) from the financial sector (http://www.ccd.gov.jo/2012).

Among the liquidated companies in Jordan are Magnesia Company which lost JD130 million (Jodeh, 2006). The consequent effect of the scenarios has already descended on the society with increased unemployment, low investment, and the overall bad economy. This situation has spelt doom to Jordanian economy, because the economy relies heavily on, apart from external aids, taxes from companies. The decrease of financial strength and liquidation of many companies has led to the increase rates of unemployment in the country (Asfor, 2003). The liquidation of firm has been attributed, among others, to the weak corporate governance practices and weak firm performance (Iskandar et al., 2011). A good number of research (e.g. Abdullatif & Al-Khadash, 2010; Ajeela & Hamdan, 2011; Bawaneh, 2011) has confirmed this scenario too.

Moreover, conflicts of interest between managers and other parties to the firms do occur. The reason is that managers effectively do control firms' assets but generally they do not have a significant equity stake in their firms (Berle & Means, 1932; Jensen & Meckling, 1976).

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Due to these conflicts, major companies such as Enron and WorldCom have collapsed (Habbash, 2010). These conflicts cannot be resolved completely through contracts because it is costly, if not impossible; to write and enforce complete contracts (Fama & Jensen, 1983; Hart, 1995). Thus, in a world with incomplete contracts, corporate governance mechanisms arise to mitigate these conflicts and to assist the firm to protect their investments to ensure continuity. Corporate governance mechanisms such as ownership structure, board of directors, audit committee and audit quality, and so on. In this study, the optimal combination of governance mechanisms is chosen to assist the firms in their continuity by limiting the conflicts between corporate managers and shareholders. Such mechanisms are likely to vary systematically across firms because these costs and benefits likely vary with firm characteristics (Leftwich, Watts & Zimmerman 1981; Agrawal &Knoeber, 1996; Boone, Field, Karpoff & Rahega, 2006; Shawtari et al., 2017).

As a result, the corporate governance mechanisms in this study will be contextual and firm-specific, given the fact that differences in the governance mechanisms and arrangements are determined by the differences in firm characteristics across countries (Carcello, Hermanson & Ye, 2011). The context within which a firm operates determines the kind of corporate governance mechanisms to be adopted (Ararat & Dallas, 2011). Hence, ownership structure, board characteristics, audit committee, internal audit, and auditor quality are the selected corporate governance mechanisms in this study.

Further, an efficient board is capable to enhance corporate governance. This is because efficient board could decrease the agency costs and overcome the conflicts that arise between the management and shareholders. In Jordan, concentrated ownership in Jordan denotes that the majority of firms in the country are led by large shareholders, including families as well as institutional investors (ROSC, 2004). There are implications following this trend of ownership. For instance, there is a possibility of large shareholders establishing power bases through their rights of voting and also by using the policies of firm to impose control on the actions of the managers to cater to their own interests. As a consequence, the agency problem could worsen while the performance of the firm becomes undermined. Nonetheless, having large shareholders could mean that the decisions of management could be monitored more closely owing to these stakeholders ’increased stake in the firm, which in turn would decrease the agency problem and enhance firm performance. The aforementioned could happen. Therefore, the study explores the effect of ownership structure on firm performance.

In addition, it is admitted that the corporate governance is still new as has been introduced mandatorily in 2009. Therefore, assessment of corporate governance taken into consideration enough periods to determine their effectiveness is of paramount importance. This is because prior research on Jordan has focused on single cross section period in immediately post the issuance and implementation of the code of corporate governance. To the view of researcher, it is important to have enough time to be considered when analyzing the effectiveness of any policy and thereon the impact of corporate governance on performance. Having enough time allows for companies to adapt to the new system and hence their impact could be seen after sometimes. Besides that one of major concern of the cross sectional studies that have been conducted previously lies in their limitation and overlook of the endogeneity problems in the paradox of corporate governance and performance. Thus, study further improves in term of time period and in term of methodological issues.

Survey of literature on board of directors-firm performance relationship has demonstrated the existence of inconsistency and inconclusiveness in the findings of the extant research. For example, Al-Zoubi (2012) documented a negative linkage between board size and earning management among the listed companies in Jordan. Apart from that, board that is smaller in size can effectually restrict the incentives director to evade their duties. This is because, as indicated

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by Haniffa & Hudaib (2006), it is easier to superintend each member. Furthermore, decision making can also be accelerated. In Jordan, the Code of Corporate Governance (2009) has defined number of board members, should be at least five to thirteen (JSC, 2009). Hermalin & Weisbach (2003) reported that companies should not appoint so many directors to the board and they suggested a maximum of seven or eight directors.

According to Lasfer (2004), directors on a large board are less likely to criticize the policies of top management, hence are subject to the control of CEO. Further, large board tends to employ less meaningful discussion since too many directors attended in the discussion, making it need more time and effort to achieve cohesiveness. Further, a large board is less effective due to the slowdown in decision making, is more averse to the risk and produces a free rider problem *i.e.,* one member will depend on other members to monitor management. However, too many people within the same location cannot work together effectively. Supporting Hermalin & Weisbach (2003); Bhagat & Black (2000) showed that large boards are less involved in strategic decision-making. Forbes & Milliken (1999) reported that a large board led to coordination problems.

Sharar (2007) is of the opinion that Jordan should abolish the policy that necessitates the directors to possess a stipulated number of shares as a qualification for board membership. The removal of such policy would encourage memberships from the independent technical and professional expertise seeing that the current trend in Jordan is the board of directors being controlled by the family owners and poor independence In the situation of Jordan, Makhlouf, BintiLaili & Basah (2014) contended that the meetings of board of directors and firm performance Good corporate governance practices require from board of directors should meet regularly to discuss the firm situations, any matter arise, or any new suggestions.

Thus, as stated by JCGC, the board of directors should conduct at least 6 meetings in a fiscal year. It should be noted however, that there has been very few researches in Jordan that look into the board of directors meetings and its impact on firm's performance. Zureigat (2014) reported that the average for board meeting is almost 6 meetings, whereas the minimum and maximum values were 2 and 14 meetings respectively. This result means that the not all the Jordanian listed firms have complied with the requirements of Corporate Governance Code which stated that the board meeting should be at least 6 year

In Jordan Aligned with the agency theory, the Jordanian Code of Corporate Governance establishes that the Chairman of the board and the CEO should hold separate responsibilities, and hence, to steer clear of conflicting interests and to uphold management supervision, the two positions should be filled by two individuals. If possible, it is important for the board to appoint the chairman from the independent directors (JSC, 2009). Abed, Al-Badainah & Serdaneh (2012) showed that there is a weakness in the monitoring function of the board of directors in Jordanian firms. They attributed the result to the nonexistence separating between CEO/chairman roles.

The inconsistency and inconclusiveness in the findings of extant corporate governance studies could, to a certain extent, be traceable to the variance in the periods during which those studies were carried out, because the evolving business and economic environment have always brought about inconsistent research results. Also, the inconsistency in the findings of extant research can be somewhat attributed to methodological styles and measures of performance adopted by those studies (Kyereboah-Coleman, 2007). The economic and financial reforms launched in Jordan were aimed at enhancing the accountability and transparency in the environment of financial so that the country could enhance its confidence in the national economy. There have been issuances and applications of many laws on the subject of corporate governance. These laws include Securities Law, Insurance Law, Company Law, Competition and Monopoly Law, Commercial Law, Banking Law, Investment Promotion Law and Privatization Law (Al-Jazi, 2007). These laws have caused the increase in foreign investors to

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the local market. Further, Jordan is in the top three countries in the Middle East and North Africa (MENA) with respect to bringing in the foreign investment (Al-Muhtaseb, 2009). Hence the effects of characteristics of board on firm performance are examined in this study.

Empirical gaps in the context of Jordan are very clear. The impact of the mandating corporate governance principles on Jordan stock market companies and their performance is neglected. A very rigorous studies has been overlooked the performance indicators and its linked with overall corporate governance. Moreover, studies have not given any consideration for the comprehensive effects of corporate governance in Jordan. In addition, to the best of knowledge, factors influencing the performance of Jordan listed companies have also not given any consideration. For example, political system, corporate capital structure, corporate governance, ownership structure, system of taxation, laws of taxation, and financial systems (bank-based in emerging markets like Jordan). It is also evident that emerging markets are characterized by less information efficiency, higher volatility, and they are smaller in size, which confines the empirical models proposed in the developed markets. In addition to the above, Jordanian firms have a highly concentrated ownership structure and following the Gulf Crises in 1991 and 2003, the Jordanian economy has been adversely impacted. Therefore, the current study suggests the importance of including the financial sector also in studies conducting in developing countries because this sector follows perfectly the principles of governance, which we believe will give clear indications about the nature of the relationship and the effect of governance in improving performance.

In this regard, Al-Malkawi's (2005); Shawtari, et al., (2016) study stressed on the lack of empirical study concerning the performance of the firms in emerging markets, especially in the case of Jordan. He added that there have been few studies dedicated to Jordanian firms' ownership structure and hence literature of this kind is still lacking. Finally, the role women on the board have not been examined for the case of Jordan.

CONCLUSION AND FUTURE DIRECTIONS

This paper aims to investigate the board characteristics for the modern firms and shows how the corporate governance has been developed in the context of Jordan. The previous literature section was highlighted with the aim of analysing its results and presenting them in a clear chronological sequence and then coming up with a set of recommendations for the purposes of guiding the upcoming and potential studies on the most important and prominent characteristics of corporate governance that positively affect the performance of companies and which of these characteristics were the cause of poor performance for the purpose of improving and developing them. A highlight on literature review in the area has been examined. Jordan Context of board characteristics and related empirical research has been discussed to show the importance of this mechanism to the development of the stock market of the country and protection of the investors. Jordan has been passed through a series of developments; however, the introduction of mandatory board characteristics principles is the hallmarks of such developments.

Empirical research in the context of board characteristic is still at its infancy stage due to the recent mandatory introduction of A highlight on literature review in the area has been examined. Jordan Context of board characteristics and related empirical research has been discussed to show the importance of this mechanism to the development of the stock market of the country and protection of the investors

Thus, few research areas could be suggested in the context of board characteristic the present research suggests comprehensive examination of the factors affecting firm performance in Jordan as a developing country because differences lie between emerging markets and

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developed ones. The variables affecting firm performance in the former could not necessarily be the same ones affecting the latter

Hence, this study suggests the comprehensive examination of these factors to differentiate whether or not the theories that have been proposed and employed in developed markets can be employed in the emerging markets. Moreover, the role of political influences an important dimension because of its significance to an emerging market such as Jordan. Political influence is suggested to be added to any analysis of board characteristic and performance relationship to reflect a significant aspect that reflects the cultural environment of Jordan. Another interested research is on the performance consequences of women's board participation. This is because studies suggest that the diversity of women bring to boards and their distinctive management style improve boards' operation; whereas others note that the limited experience of women in leadership positions and their lesser drive to advance to the top are characteristics that could diminish their effectiveness as board members (Nielsen & Huse, 2010; Dargnies, 2012).

Such diversity of the previous theoretical and empirical evidence stimulates the researcher to suggest this research for the case of new context of Jordan, and related to the empirical research has been discussed to show the importance of this mechanism to the development of the stock market of the country and protection of the investors. Jordan has been passed through a series of developments; however, the introduction of mandatory corporate governance principles is the hallmarks of such developments. Empirical research in the context of corporate governance is still at its infancy stage due to the recent mandatory introduction of corporate governance guiltiness.

Thus, few research areas could be suggested in the context of corporate governance. The present research suggests comprehensive examination of the factors affecting firm performance in Jordan as a developing country because differences lie between emerging markets and developed ones. The variables affecting firm performance in the former could not necessarily be the same ones affecting the latter. Hence, this study suggests the comprehensive examination of these factors to differentiate whether or not the theories that have been proposed and employed in developed markets can be employed in the emerging markets. Moreover, the role of political influences an important dimension because of its significance to an emerging market such as Jordan.

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