

THE INFORMATION CONTENT OF CORPORATE GOVERNANCE

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ABSTRACT

Corporate governance is the system of practices, rules, and processes which control and direct a company. Corporate governance essentially consists of balancing the interests of a company's many stakeholders, such as managers, shareholders, customers, suppliers, government officials, financiers, and communities. This study empirically investigated the impact of corporate governance components on the capital structure decisions of Jordanian banks. The study used regression model on 13 Jordanian banks, the total number of observations for analysis was 104. and found that board size did not have a significant positive impact on debt ratio and the ownership concentration coefficient was not significant, which indicated that this factor did not have an effect on banks' debt-ratio values. This may be due to the fact that banks increase protection against risks when they have more corporate governance tools, and this strengthens the bank's ability to increase internal funds. The study recommended that some measures of capital structure need more investigations in the future and future studies may include more tools.

Keywords: Capital Structure, Corporate Governance, Ownership Concentration, Board Size, Jordanian Banks.

INTRODUCTION

Financing choices for a company are of basic significance to its management. These choices incorporate the assurance of an ideal capital structure of a firm. Theoretically, there are various capital structure hypotheses accessible in this way. The optimal mix of equity and debt financing choices are critical to the achievement of the organizations. Even, however there is an increasing body of literature on capital structure and corporate governance practices, there is a decent variety of results because of the several theoretical perspectives applied, choice of procedures, estimation of factors, clashing perspectives on board association in basic leadership and the contextual nature of companies (Shafana, 2016). When making financing choices, the component of corporate governance ought to likewise be remembered. Corporate governance tools are seen as a mind-boggling arrangement of controls from a more extensive point of view (Zingales, 1998). Capital structure is the mix of debt and equity at different levels of securities in a company. Regardless of any specific definition, corporate governance tools consist of two groups, i.e. both external and internal to business firms (Stuart, 2006). There has been a developing awareness of corporate governance in Jordan. Because of that, organisations currently are required to conform to the corporate governance rules that form part of the listing procedures. The agency problem is considered an important driver of the corporate governance mechanism and includes financing choices of an organisation, and managers could affect the level of use that is financed by the outside sources, as indicated by their propelled interests. The relationship between capital structure and profitability cannot be ignored because improvement in profitability is necessary for the long-term solvency of a company. When managers settle on financing choices about utilisation in the capital structure of a company, the component of corporate governance ought also to be considered (ROSC, 2005). Therefore, the primary goal

of this study was to empirically inspect the impact of the components of corporate governance on capital structure choices of the Jordanian banks.

Research Problem

Standard financial theory provides a model for the optimal capital structure of every company. This model holds that shareholder wealth-maximization results from decreasing the WACC (weighted-average cost of capital). Therefore, the management focus should not be on increasing earnings per share (EPS can be maximized by taking on more debt, but debt increases risk). Capital structure determination is one of the important corporate financing choices and managers frequently stand up to trouble in finding the ideal one. The capital structure decision is significant for companies. The capital structure choice is vital because of the need to increase returns of the companies. There are different theories with respect to this wonder in the accounting literature and this topic has been discussed. Presently, the need to decide an optimal capital structure has turned out to be more troublesome and in addition vital because of the development of a need for the best corporate governance rehearses.

LITERATURE REVIEW

Modigliani & Miller (1958) introduced the insignificance theory of capital structure, there has been a continuous talk on the point. A short time later, with the presentation of bankruptcy costs, taxes, the realization of asymmetric information and debt expenses differences. There is not one solitary determinant or factor of capital structure; rather, it is the result of firm-particular factors as well as a company's governing tools, institutional framework and legal environment, which all contribute jointly to assure an optimal capital structure (Deesomsak, Paudyal & Pescetto, 2004). As indicated by Velnampy & Aloy Niresh (2012), an effective choice for use of capital is one of the key components of a financial strategy for a company. On the other hand, according to Kajanathan (2012), the current advances in regulatory frameworks and corporate governance practices in Sri Lanka may influence capital structure decisions and choices in industrial firms. Goel & Ritu, (2015) investigate the empirical studies and theoretical concepts related to the impact of corporate governance mechanisms on firm's capital structure. The study breaks down variables of corporate governance mechanisms such as board skills, composition, and size. The key finding of the research is that the empirical results on the relationship between corporate governance and capital structure of firms tend to be varied and inconclusive. Results vary from business sectors to business sectors due to differences in their ownership structure, institutional and legal systems. Wellalage & Lock (2012) discovered that CEO duality, insider ownership, and non-executive directors have an important effect on the capital structure. But, ownership type and board size have no significant effect on the capital structure. In another hand, Somathilake and Udaya kumara (2015) examined also the association between capital structure and corporate governance and discovered that board structure has an important effect on the capital structure. Wiwattanakantang (1999) found in his research an insignificant relationship between the CEO, debt ratio, and managerial holding. However, Fosberg (2004) proposed an inverse significant relationship between leverage employed and CEO holdings in capital structure. Bathala et al. (1994) also found an inverse association between managerial ownership and company debt.

Huang & Song (2006) studied Chinese listed companies and also reported a negative relationship between debt-ratio and managerial holdings. Bokpin & Arco (2009) found a significant positive effect of executives' holdings on debt to equity choice in Ghana. Naseem et al., (2017) examined the impact of corporate governance on capital structure determination

and focused on well-known capital structure theories (agency theory, trade-off theory, and pecking-order theory) on non-financial Pakistan firms. The main results were that Pakistani companies had a direct relationship between capital structure and managerial ownership, the significant negative relationship has been found between debt ratio and liquidity, negative relationship between debt ratio and return on assets, and the association with company size is negative and additionally insignificant. Siromi & Chandrapala (2017) looked at whether characteristics of corporate governance influenced decisions on the capital structure of listed firms in Sri Lanka. The study sample from 2009 to 2013 was represented by 138 non-financial listed companies. Leadership structure, board size, board committees, managerial ownership, and board composition were used as corporate governance tools, the control variables were the debt ratio as a measure of capital structure, firm size, and ROA. This research is most similar to my study and the findings indicated that there was an insignificant impact of corporate governance tools, except for board committees and board composition, on capital structure

RESEARCH METHOD

Study Sample

All shareholding companies in the bank sector that had availability of share prices and other required data during the study period 2009-2016 did not enter in any extraordinary process like consolidation because this would have influenced the bank figures, such as income. (13) Banks are representing the study sample. The banks are Arab Bank, Jordan Ahli Bank, Cairo Amman Bank, Housing Bank, Jordan Kuwait Bank, Arab Jordan Investment Bank, Jordan Commercial Bank, Invest Bank, Arab Banking Corporation Bank, Bank Al Etihad, Societe General Bank Jordan, Capital Bank and Bank of Jordan.

Study Hypotheses

Debt Ratio and Board Size

A board of directors (BOD) is a group of individuals that are elected as, or elected to act as, representatives of the stockholders to establish corporate management related policies and to make decisions on major company issues. A viable BOD is important for the fruitful operations of an organization. As imperative and vital bearing of an organization relies on the accord of the board members. Therefore, board size is considered important in selecting financing mix of the organization. Board of directors is vital aspect as they influence the reliability of annual financial reports (Anderson, Mansi, and Reeb, 2004). Anderson et al (2004) found that Board size has a negative association with the cost of debt.

Several evidences are found on the capital structure and board size. Adams & Mehran (2003) reasoned that a board that is larger in size can take better choices. However, Lipton & Lorsch (1992) discovered that smaller boards are more efficient and effective and larger boards are a waste of resources. An inverse relationship was observed between board size and leverage by Berger, Ofek, & Yermack in 1997. Wiwattanakantang (1999) and Hussainey & Alfieri (2012) found an insignificant inverse association between the leverage and board size. Anderson et al. (2004) proposed that a larger board would bring the advantage of lower cost of debt financing. On the other hand, Bokpin & Arco (2009) and Abor (2007) found that there was an important direct association between board size and capital structure. Wen et al. (2002) also found this kind of positive and insignificant association on Chinese listed companies. Therefore, the study first hypothesis is as follows:

H1a: Board size has a significant impact on Debit ratio.

Ownership Concentration and Debt Ratio

The concept of corporate governance covers a large number of distinct economic relations. One such relation is corporate ownership Concentration. There is strong evidence to support the observation that the variations of ownership concentration across firms result in systematic variations in firm performance (Suto, 2003). Therefore, the second hypothesis is:

H1b: Ownership Concentration has a significant relationship with Debit ratio.

Variables and Methodology

Jordanian companies listed on the Amman Stock Exchange (ASE) were used to investigate the impact of corporate governance in an emerging market on capital structure. The annual data were collected for the period between 2009 and 2016. There were 13 selected banks, so the total number of observations for analysis was 104.

The study model was used to estimate the relationship between capital structure and corporate governance.

$$DR_{it} = \beta_0 + \beta_1 BS_{it} + \beta_2 CONC_{it} + \beta_3 FS_{it} + \beta_4 ROA_{it} + \beta_5 LIQ_{it} + \epsilon_{it}$$

This following section shows the study variables.

Debt to total assets (DR) The dependent variable; which is equal the ratio of total debt to total assets and used as representative of capital structure.

Board Size (BS) equals the total number of non-executive and executive board members. Used as an explanatory variable for corporate governance is in this study and Ownership Concentration (CONC) is another explanatory variable for this study is obtained and as the ratio of shareholders that own more than 5% of shares (Noorafshan et al 2014).

Firm size (FS) a control variable in this study and measured by total assets.

Return on Assets (ROA) another control variable and defined as the ratio of net income to total assets.

Liquidity (LIQ) is computed as the ratio of current assets (CA) to current liabilities (CL) and considered as the third control variable in this research.

Tables (1) show the descriptive measures for the main variables. The descriptive measures include the minimum value, mean, maximum value and standard deviation.

Variable	DR	BS	CONC	FS	ROA	LIQ
No.	104	103	104	104	103	104
Mean	0.856	11	61.5	9.29	0.013	0.321
SD	0.026	1.709	20.314	0.429	0.005	0.08
Minimum	0.78	7	31.17	8.48	0.001	0.16
Maximum	0.91	15	89.24	10.41	0.025	0.5

The debit ratio average was 6.2. This meant that Jordanian banks naturally depend on debit which mainly represented the clients' deposits, and demonstrated excessive use of debt by Jordanian banks. A higher debt ratio is an indicator of volatility in earnings and presents a higher risk, due to higher interest exercises. The number of directors on boards ranged from 7 to 15, with an average of 7 with a standard deviation of 1.71 in Jordanian banks. The second indicator of corporate governance used in this study was ownership concentration. CONC ranged from 31.17% to 89.24% and the average for Jordanian banks was 61.5%. The range of profitability varied between near zero and 2.5%. The low values showed a failure of management to generate profits out of the bank's resources. The higher the return on assets of a firm, the better it is in using its investment assets to generate income. The average value was positive which shows that the financial banks were generating profits. In addition, it was observed that there was low volatility in the profits of these banks (evident from the low value of 0.4% for standard deviation). Finally, liquidity, as calculated by using a current ratio, ranged from a minimum value of 0.16 to 0.5. A company with a higher liquidity ratio is considered better than a bank with a lower current ratio. There was a significant relationship between debt ratio and ROA, and between the size of the board of directors and ownership concentration and firm size, as shown in table 2.

Variable	DR	BS	CONC	FS	ROA	LIQ
DR	1					
BS	0.058	1				
CONC	-0.013	-0.44**	1			
FS	0.119	-0.259**	-0.347**	1		
ROA	-0.171*	0.053	0.082	-0.02	1	
LIQ	-0.158	0.179	-0.147	-0.421**	-0.001	1

* Correlation is significant at the 0.05 level (2-tailed).
** Correlation is significant at the 0.01 level (2-tailed).

On the other hand, firm size had a significant relationship with the majority of study variables. This meant that a company's size would be higher in banks that have good liquidity, bigger board size, and a high percentage of ownership concentration. The significant relationships amongst the study variables could create a multicollinearity problem that decreases the model's ability in clarifying the results. Variance Inflation Factor (VIF) factors, which refers to the actual divergence percentage to the total divergence, have been used in this study, and a multicollinearity problem was not found if this factor was less than 5. As observed from the table 3, there was no multicollinearity problem in the regression models. Because all VIF factors are less than 5.

Model	VIF
$DR_{it} = \beta_0 + \beta_1 BS_{it} + \beta_2 FS_{it} + \beta_3 ROA_{it} + \beta_4 LIQ_{it} + \epsilon_{it}$	1.256
$DR_{it} = \beta_0 + \beta_1 BS_{it} + \beta_2 CONC_{it} + \beta_3 ROA_{it} + \beta_4 LIQ_{it} + \epsilon_{it}$	1.254

Durbin-Watson factors is used to test the autocorrelation among regression model residuals, if Durbin-Watson factors less than (2) there is no autocorrelation problem as in our study as shown in the table (4).

Model	Durbin-Watson Factors
$DR_{it} = \beta_0 + \beta_1 BS_{it} + \beta_2 FS_{it} + \beta_3 ROA_{it} + \beta_4 LIQ_{it} + \epsilon_{it}$	0.653
$DR_{it} = \beta_0 + \beta_1 BS_{it} + \beta_2 CONC_{it} + \beta_3 ROA_{it} + \beta_4 LIQ_{it} + \epsilon_{it}$	0.616

The impact of corporate governance on company’s capital structure was examined by using the regression models analysis to find out the significant effect of independent and control variables on the capital structure as the dependent variable (Siromi and Chandrapala, 2017). The first hypothesis coefficients are shown in table 5.

	Constant	BS _{it}	FS _{it}	ROA _{it}	LIQ _{it}	F-statistic	Adj R ²
coefficients	0.763	0.001	0.013	-0.928	-0.078	(2.662)*	0.062
t-values	(13.702)**	0.787	1.951	-1.776	(-2.29)*		

* Correlation is significant at the 0.05 level (2-tailed).
** Correlation is significant at the 0.01 level (2-tailed).

This regression analysis showed a positive Adj R2 and a significant f-test. However, the main independent variable coefficient in the model (size of board of directors) was insignificant. Therefore, the first alternative hypothesis was rejected, as the board size did not have a significant positive impact on DR ratio. Nevertheless, the banks that could generate high returns from employed assets and cover their liabilities from current assets did not need more debt. To test the second hypothesis, table 7 represents the results of the coefficients. The figures indicate that there was a small decrease in Adj R2 from 6.9% in the first model to 4.9% in this model. The ownership concentration coefficient was not significant, which indicates that this factor did not have an effect on bank debt ratio values. So, the second alternative hypothesis was also rejected and the ownership concentration did not have a significant positive impact on debit ratio.

	Constant	CONC _{it}	BS _{it}	ROA _{it}	LIQ _{it}	F-statistic	Adj R ²
coefficients	0.863	1.989	0.002	-0.970	-0.052	(1.652)*	0.025
t-values	(34.357)**	0.143	1.135	-1.810	-1.662		

* Significant at the 0.05 level (2-tailed).
** Significant at the 0.01 level (2-tailed).

CONCLUSION

Firms cannot identify the optimal capital structure precisely, So they should attempt to find an optimal range for the capital structure. Each additional JOD raised becomes increasingly expensive as investors demand higher returns to compensate for increased risk. The results led to the following findings: the board size did not have a significant positive impact on debit ratio and the ownership concentration coefficient was not significant, which indicated no effect on bank debt ratio value. The study tries to find evidence that Board size can play a role in determining companies’ capital structure. The study first result is in line with the findings of Siromi & Chandrapala (2017). Our results did not confirm those of Adam and Mehran (2003) who found that a larger size of boards could monitor management and make better decisions than others. Bokpin & Arco (2009) and Abor (2007) conducted research on Ghanaian firms and discovered that there was a positive association between the

size of the board of directors and capital structure. Ownership concentration was considered to be an effective tool against agency problems. Higher ownership concentration pointed towards the higher use of external funds and this indicated alignment of interest of management and shareholders. In model 2, ownership concentration did not have an insignificant effect on debt ratio. The negative and significant relationship between capital structure and profitability suggests that Jordanian banks earn higher returns on investments and such banks rely more on equity resulting the decreasing use of debt. This result supports the pecking order theory of capital structure proposed by Myers (1984). Previous researches on the topic like Chhapra & Asim (2012) Huang & Song (2006) Booth et al (2001), Zingales (1998) & Myers (1984) also confirmed these results. This study examining the association between capital structure and liquidity as examined by Naseem et al., (2017) and Lipson and Mortal (2009), the significant inverse relationship has been found so the companies with higher equity enjoy the benefit of lower expenses resulting in the choice of interact sources to finance their projects. Therefore, more liquid companies have a lower need for leverage. It also true in case of Jordanian banks.

Recommendations

Recommendations are offered as follows:-

The banks should concentrate more on corporate governance factors and all the relevant components should be used to keep overall control over firm leverage ratios, several studies on Jordanian non-financial banks could be conducted in this important area, some measures of capital structure need more investigations in the future and further studies may include more tools, such as the effect of board structure, CEO duality, and CEO characteristics.

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