International Journal of Economics and Finance; Vol. 9, No. 7; 2017
ISSN 1916-971X E-ISSN 1916-9728
Published by Canadian Center of Science and Education

Exploring the Role of Board Characteristics on Enhancing Financial Performance of Jordanian Listed Companies

Laith A. Alaryan[1]

[1] Ajloun National University, Ajloun, Jordan

Correspondence: Laith A. Alaryan, Ajloun National University P. O. Box 43, Ajloun 26810, Jordan. E-mail: Laith.Aryan@anu.edu.jo

Received: February 13, 2017 Accepted: May 25, 2017 Online Published: June 15, 2017

doi:10.5539/ijef.v9n7p99 URL: https://doi.org/10.5539/ijef.v9n7p99

Abstract

Corporate governance considered important topic at the local and international levels, especially after many financial crises and corporate failures and such as Enron and World Com This paper aims to explore the role of board characteristics, (i.e. board size, board composition and board leadership structure) on enhancing firms' financial performance; this study used the non-financial companies' annual reports for 6 years (2011-2016) to extract the needed information. The non- financial sector consisted form 167 companies, only 139 companies are included in this study due the lack of data during study's period. The results revealed that there is a positive role for board composition, board leadership structure, board size, on enhancing financial performance, while there is no significant role for board tenure, on financial performance. These mixed results on the relationship between board characteristics and financial performance have opened up possible research area in the future. For instance, extending the sample to comprise more sectors from Amman Stock Exchange is worthwhile to further support or refute the results of this study.

Keywords: financial performance, board size, board composition and board leadership structure

1. Introduction

1.1 Introduction and the Problem

Corporate governance considered important topic at the local and international levels, especially after many financial crises and corporate failures and such as Enron and World Com. The corporate governance mechanisms are needed to restore the investors' confidence the financial markets. The OECD (2005) defines corporate governance as "procedures and processes according to which an organization is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organization such as the board, managers, shareholders and other stakeholders and lays down the rules and procedures for decision-making" (p. 1).

The key role of corporate governance in enhancing firms' financial performance and protecting stakeholders interest was highlighted by many researchers. In line with the interest of financial performance, this study seeks to examine whether board characteristics (namely, board size, board leadership structure and board composition) play a role in enhancing financial performance. There is a need to provide empirical evidence on these relationships to see whether the corporate governance mechanisms are effective in enhancing the financial performance in Jordanian context.

The need to examine the role of board characteristics on financial performance is motivated by the recent interest showed by the government of Jordan in corporate governance especially when the companies' law no. 23, 1997 was issued. Thereafter, the listed companies at Amman Stock Exchange (ASE) should form boards and committees to apply corporate governance mechanisms. Securities law issued in 2002 also requires the public companies to apply corporate governance to enhance the transparency and accountability of financial statements in Jordan. After the financial crises in 2008, the Jordan Securities Commission issued the "Corporate Governance Code for Shareholding Companies Listed on the Amman Stock Exchange 2009" to define the responsibilities and duties of boards and committees in public companies.

1.2 Objective of the Study

The objective of the study is to examine the role of board characteristics (i.e. board size, proportion of non-executive directors, board dual leadership, COE tenure) in enhancing firms' financial performance controlled by company size and leverage.

1.3 Literature Review

This section provides a revision for prior research on the role of board characteristics and firm's financial performance. In some cases, due to the lack of literature on these relationships, the researcher has discussed the relationship of board characteristic with some other variables as exhibited below.

Previous researchers reported mixed results on this relationship. For instance, Odudu et al (2016) investigated the influence of Board Characteristics on the Financial Performance of listed deposit money banks in Nigeria for the period of 2005-2014. The study categorically seeks to examine whether board characteristics has any influence on the Performance of listed Deposit Money Banks in Nigeria. The study adopted multiple regression technique as a tool of analysis and data were collected from secondary source through the annual reports and accounts of the sampled banks. The findings show that foreign director is significant and positively correlated or influence the Performance of deposit money bank, while the grey director have negative significant effect on the Performance of deposit money banks in Nigeria. Other variables such as executive director, independent non-executive director and women director have no significant impact on banks performance in Nigeria. Therefore, the study among others recommended that the management of deposit money banks in Nigeria should increase the number of foreign directors on board to a certain number as they have skills, experts, experiences and would like to protect their integrity, reputation and professional competence with creativity and innovation to manage the relationship between the boards and stakeholders leading to an improvement in the bank financial performance.

Amran (2014) examines the relationship between board characteristics and company performance in Nigeria. The study uses multiple regression technique on 90 sampled firms from the main board of Nigerian Stock Exchange from 2010 to 2012. The empirical evidence shows that board size and board education are positively and significantly related to company performance. While there is no relationship between board equity, board independence, and board age. Also, this study evidences a negative significant between board women and turnover. Their appointment is window dressing as the percentage is too small for meaningful positive effect on company performance.

Al-Matari et al. (2012) aimed to examine the relationship between board characteristics and the firm performance of non-financial listed Kuwaiti firms. To achieve the objectives of the study, the data were collected from a sample of 136 companies for the financial year 2009. Variables such as CEO duality, COE tenure, board size and board composition were considered as predictors of the firm performance that was measured employing the return on assets (ROA). By contrast, the effects of CEO tenure and leverage on firm performance were found to be negative and significant at the chosen level of significance. To test the hypotheses of the study, Using the firm size and leverage as a control variable, the findings of the study support the positive effects of CEO duality and audit committee size on ROA. Other findings of the study were discussed in the section and some other future study directions were provided.

Ujunwa (2012) investigated the impact of corporate board characteristics on the financial performance of Nigerian quoted firms. He found that board size, CEO duality and gender diversity were negatively linked with the firm performance, whereas board nationality, board ethnicity and the number of board members with a PhD qualification were found to have a positive impact on firm performance. The result of the robustness test using the same board characteristics for 160 small firms showed that board duality was positively linked to firm performance, while a PhD qualification was negatively linked to firm performance.

Barako et al. (2006) state that non-executive directors play an important role as a reliable mechanism to diffuse agency conflicts between contracted parties, they are viewed as providing the necessary revision to enhance board effectiveness. Agency theory postulates that higher percentage of non-executive directors enhances the quality of earnings (Hashim & Devi, 2008). Similarly, Cheng and Courtenay (2006) relate a board's monitoring effectiveness to its composition; they argue that the higher the independent board members, the greater monitoring ability over management. Leftwich, Watts and Zimmerman (1981) state that the effectiveness of monitoring managerial opportunism increases in the case of existence of larger proportion of non-executive directors on the board.

Suarez et al. (2015) analyzed the effect of certain characteristics of board of directors in Spanish non-listed family firms have on performance. The results show a negative effect of a higher proportion of executive directors and a positive effect of CEO duality, while no effects were found in relation to the diversity of family directors (executive or non-executive) on the firms' performance. In relation to the effect of outside boards, the influence on performance is negative except when this variable was considered in interaction with CEO duality. In this case, the effect on performance was positive. Ongore et al. (2015) investigated the effects of board composition on financial performance, they found that independent board members had insignificant effect on financial performance, but gender diversity did, in fact, have significant positive effect.

Ongore et al. (2015) added that board size, on the other hand had an inverse relationship with financial performance. These results are largely consistent with conceptual and empirical literature on corporate governance with respect to small board size (5 to 7) that is sufficiently diverse in terms of gender, skill, experience, industry networks, among other important attributes. Regarding outside directors, however, the study findings appear to contradict the long-held traditional view that outsiders confer superior performance to the board. Gonzales-Bustos et al. (2014) aimed to develop an exploratory analysis of the board composition of Spanish companies that belong to innovative economic sectors. They tested the relationship between board composition and innovation, exploring the characteristics of the board in an organizational context of innovative behavior. The results confirm the relevance of medium size boards with a majority of affiliated directors and CEO duality; male directors are predominant, but the proportion of women, despite its minimum level, is significantly growing. There are relevant differences in the board composition of different Spanish innovative sectors. However, its evolution over time is quite stable, with the exception of the proportion of women on the board. This board composition is characteristic in situations in which the innovative behavior of companies is significantly improving.

Bradbury et al. (2006) found that a small board is more efficient in monitoring management while Yuemei and Yanxi (2007) found a negative relationship between earnings management and board size. Also, Wenyao and Qin (2008) found that small boards are more effective in constraining income-increasing earnings management than a large board. Meca and Ballesta (2009) found a negative relationship between board size and discretionary accruals. Klai and Omri (2011) revealed that the size of board is related to the quality of financial reporting. On the other hand, Xia and Zhao (2009) found that the supervisory board size has no significant correlation with earnings management. Similarly, Sarikhani and Ebrahimi (2011) found no significant relationship between board size and earnings informativeness. Gulzar and Wang (2011) also found no significant relationship between board size and earnings management. The chair of the board of directors and CEO positions should be held by different persons or by one person.

According to agency theory, the combined functions can significantly impair the boards' most important function of monitoring, disciplining and compensating senior managers. It also enables the CEOs to engage in opportunistic behavior because of their dominance over the board, (Barako et al., 2006). Agency theory proposes that the separation of duties may lead to efficient monitoring over the board process. Thus, CEO duality will impair the supervisory role of the board. CEO duality indicates that less control is likely to be exercised over management's activities and behavior (Meca & Ballesta, 2009).

Davidson et al. (2004) found a positive relationship between existence of dual leadership and earning management. Saleh et al. (2005) assessed the effectiveness of board characteristics in terms of preventing earnings management in Malaysia. They found that the existence of CEO-Chairman duality is related positively with earnings management.

Many studies have found a positive significant relationship between the existence of CEO-Chairman duality and earnings management, for example, Gulzar and Wang (2011) Roodposhti and Chashmi (2011) and Ghosh et al. (2010) found that the separation of CEO/Chairman positions is related negatively with earnings management. On the other hand, other studies found no relation between CEO duality and earnings quality, for example Johari et al. (2008) found no relationship between CEO duality and earnings management practice in Malaysia. Similarly, Wenyao and Qin (2008) found that separation of CEO and chairman positions does not enhance monitoring of earnings management. Meca and Ballesta (2009) also found no relationship between the existence of Chairman/CEO duality and increasing probability of earnings management. Similarly, Sarikhani and Ebrahimi (2011) revealed no relationship between board leadership structure and earnings informativeness.

1.4 Hypotheses of the Study

Based on the previous literature and agency theory assumption, the hypotheses of the current study were formulated as follows:

H1: There is a positive role for Board composition on enhancing firm's financial performance.

H2: There is a positive role for board size on enhancing firm's financial performance.

H3: There is a positive role for Board leadership structure on enhancing firm's financial performance.

H4: There is a positive role for Board Tenure on enhancing firm's financial performance.

2. Method

2.1 Population and Sampling

Sekaran and Bougie (2010) refer to population as the entire group, events, or things of interest that the researcher wishes to investigate, and the sample is a subset of the population. In this study, the population is Jordanian external auditors. They defined sampling process as selecting a sufficient number of elements from population.

This study tested the non-financial listed companies in Amman Stock Exchange (ASE) from 2011 to 2016. The non- financial sector consisted form 167 companies, only 139 companies are included in this study due to lack of data during study's period (ASE, 2016) thus 28 companies were excluded.

2.2 Measurements

The measurements of the variables were as follows:

Board composition

Board composition was measured as percentage of non-executive directors to total number of directors.

Board size

Board size means total number of directors on the board of company including CEO and Chairman. Board size is measured as the total number of board's directors.

Board leadership structure

The board with dual leadership structure (CEO and chairman) was scored as 1 and 0 for unitary leadership structure.

Board Tenure

A board's tenure in a company, or the period during which the board occupies its position.

Financial performance

This study has used ROA as a proxy for firm's financial performance.

Linearity, normality, and homoscedasticity

Linearity, normality, and homoscedasticity are other important assumptions that should be checked before regression test is performed. The need for normally distributed data is because the correlation represents a linear association between the variables while the nonlinear association is not represented. So, the scatter plots should express the normal line for the independent and dependent variables. According to Hair et al. (2010), testing the normality of the data can be done by exploring skewness and kurtosis ratio. Normality is assumed when the skewness and the kurtosis are between ± 1.96 at alpha value .05 and ±2.58 at alpha .01, respectively.

The scatter plots diagram various variables and the scatter plot diagrams of standardized residuals show no indication of the presence of nonlinear responses in the data, it also shows that the variance of the dependent variable is the same for all values of the independent variables as no nonlinear pattern is observed. The results of normality test (comprising the Q-Q plot and detrended Q-Q plot) of the data shows that the data represent a sample of normal population distributed homogeneously.

3. Results

3.1 Hypotheses Testing

The objectives of this study are to test the role of board characteristics on enhancing firm financial performance. R square shows how much of the variance in the dependent variable is explained by the model, in this study, R square was .326 which means this model explain 32.6% of the variance in firm's financial performance. F value = 26.547, P= 0.001.

The result of multiple regression between independent variables (i.e. Board composition, Board size, Board leadership structure, and Board Tenure) and firm's financial performance shows a positive role for board composition, board size, and board leadership structure on enhancing firm's financial performance, while there is no role for board tenure.

Regrading control variables, table 1 showed that the firm size and leverage are positively and significantly affect the firm's financial performance. Table below summarizes these results.

H1: There is a positive role for Board composition on enhancing firm's financial performance.

The result of multiple regression shows that the *beta* value is 0.158 (t = 1.919, P. = 0.005), as shown in Table 1. This means that board composition is significantly and positively related to firm's financial performance. Table 1 below shows that board composition enhances significantly the dependent variable (firm's performance), in which for one unit increase in the independent variable, the dependent variable (firm's financial performance) will increase by 0.158 Based on this result, the first hypothesis is supported.

H2: There is a positive role for board size on enhancing firm's financial performance.

Table 1 exhibits the results of regression test between board size and firm's financial performance and shows that the *beta* value is 0.254 (t = 3.699, p.=0.14). This means there is a positive significant relationship between board size and firm's financial performance. Hence, the second hypothesis is supported.

H3: There is a positive role for Board leadership structure on enhancing firm's financial performance.

The results show that the beta value is 0. 299 (t = 4.547, P. < 0.000). This means that Board leadership structure has a positive and significant relationship to firm's financial performance. Table 1 shows that for each unit increase in the Board leadership structure there is an expected increase in to firm's financial performance by .299. Hence, the third hypothesis is supported

H4: There is a positive role for Board Tenure on enhancing firm's financial performance.

Table 1 presents the results of regression between Board Tenure and firm's financial performance. It shows that beta value is 0. 059 (t = 1.052, Sig. = 0.065). This means that there is no significant relationship between Board Tenure and firm's financial performance. Hence, the fourth hypothesis is not supported.

Table 1. Results of multiple regression

	Unstandardized Coefficients		Standardized Coefficients		
Model	B	Std. Error	Beta	t	Sig.
(Constant)	1.031	.012		7.215	.000
Board composition	.125	.014	.158	1.919	.005
board size	.198	.020	.254	3.699	.014
Board leadership structure	.281	.013	.299	4.547	.000
Board Tenure	.034	.024	.059	1.052	.065
Firm size	.138	.017	.454	11.217	.000
Leverage	.190	.013	.358	10.328	.000

3.2 Discussion

The result of multiple regression between independent variables (i.e. board composition, board size, board leadership structure, and board tenure) and firm's financial performance shows a positive role for Board composition, board size, board leadership structure on enhancing firm's financial performance, while there is no role for board tenure. The result of the current study has documented that the firm size and leverage enhance the firm's financial performance.

These results confirm some previous studies, such as Al-Matari et al. (2012) aimed to examine the relationship between board characteristics and the firm performance of non-financial listed Kuwaiti firms who found a positive role for CEO duality and on enhancing financial performance. Similarly, Ujunwa (2012) showed that board duality was positively linked to firm performance. Odudu et al. (2016) found that foreign director is significantly and positively correlated or influenced the Performance.

These mixed results on the relationship between board characteristics and financial performance have opened up possible research areas in the future. For instance, extending the sample to comprise more sectors from Amman Stock Exchange is worthwhile to further support or refute the results of this study.

The findings of this study shed light on the relationship between board characteristics and company's performance. The implication of these findings is important in many ways, i.e. the board characteristics is vital for a company performance, hence, the prospective investors should consider these forms when investing in companies.

This study is conducted on industrial and services sectors only, the financial sector is excluded since it has different regulation and corporate governance code. It will be beneficial to conduct a study on this sector to show

how the ownership structure influence the financial performance in financial sector. Regarding to the methodology, we have used quantitative method to achieve the objectives of the current study, using qualitative method will expand the literature on this issue and provide empirical evidence on the experts view on this issue. Moreover, the results show that R^2 value is average which means there is an opportunity to explore new explanatory variables to support the results of this study and to expand the literature on these issues especially in developing countries.

References

Akpan, E. O., & Amran, N. A. (2014). Board characteristics and company performance: Evidence from Nigeria. *Journal of Finance and Accounting*, *2*(3), 81-89. https://doi.org/10.11648/j.jfa.20140203.17

Al-Matari, Y. A., Al-Swidi, A. K., Fadzil, F. H. B., Fadzil, H., & Al-Matari, E. M. (2012). Board of Directors, Audit Committee Characteristics and the Performance of Saudi Arabia Listed Companies. *International Review of Management and Marketing*, *2*(4), 241.

ASE. (2015). Amman Stock Exchange. Retrieved from http://www.ase.com.jo/pages.php?menuid=119&local_type=0&local _id=0&local_details=0

Augustine, U. (2012). Board characteristics and the financial performance of Nigerian quoted firms. *Corporate Governance: The International Journal of Business in Society*, *12*(5), 656-674. https://doi.org/10.1108/14720701211275587

Barako, D., Hancock, P., & Izan, H. (2006). Factors influencing voluntary corporate disclosure by Kenyan companies. *Corporate Governance: An International Review, 14*(2), 107-125. https://doi.org/10.1111/j.1467-8683.2006.00491.x

Bradbury, M. E., Mak, Y. T., & Tan, S. M. (2006). Board characteristics, audit committee characteristics and abnormal accruals. *Pacific Accounting Review, 18*(2), 47-68. https://doi.org/10.1108/01140580610732813

Cabrera-Suárez, M. K., & Martín-Santana, J. D. (2015). Board composition and performance in Spanish non-listed family firms: The influence of type of directors and CEO duality. *BRQ Business Research Quarterly, 18*, 213-229. https://doi.org/10.1016/j.brq.2014.08.001

Cheng, E. C. M., & Courtenay, S. M. (2006). Board composition, regulatory regime and voluntary disclosure. *The Intern. J. Account, 41*(3), 262-289.

Davidson, W., Jiraporn, P., Kim, Y. S., & Nemec, C. (2004). Earnings management following duality-creating successions: Ethnostatistics, impression management, and agency theory. *Acad. Manag. J., 47*(2), 267-275. https://doi.org/10.2307/20159577

Ghosh, A., Marra, A., & Moon, D. (2010). Corporate boards, audit committees, and earnings management: Pre- and Post-SOX evidence. *J. Bus. Finan. Account, 37*(9), 1145-1176. https://doi.org/10.1111/j.1468-5957.2010.02218.x

Gonzales-Bustos, J. P., & Hernández-Lara, A. B. (2014). An exploratory analysis of the board composition in Spanish innovative firms. *European Accounting and Management Review, 1*(1).

Gulzar, M., & Wang, Z. (2011). Corporate governance characteristics and earnings management: Empirical evidence from Chinese listed firms. *Intern. J. Account. Finan. Reporting, 1*(1), 133-151. https://doi.org/10.5296/ijafr.v1i1.854

Hair, J. F., Black, W. C., Babin, B. J., Anderson, R. E., & Latham, R. (2010). *Multivariate data analysis* (7th ed). New Jersey: Pearson.

Hashim, H. A., & Devi, S. S. (2008). Board independence, CEO duality and accrual management: Malaysian evidence. *Asian J. Bus.Account, 1*(1), 27-46.

Johari, N. H., Saleh, N. M., Jaffar, R., & Hassan, M. S. (2008). The influence of board independence, competency and ownership on earnings management in Malaysia. *International Journal of Economics and Management, 2*(2), 281-306.

Klai, N., & Omri, A. (2011). Corporate governance and financial reporting quality: The case of Tunisian firms. *International Business Research, 4*(1), 158-166.

Leftwich, R., Watts, R., & Zimmerman, J. (1981). Voluntary corporate disclosure: The case of interim reporting. *J. Account. Res., 19*(3), 50-77. https://doi.org/10.2307/2490984

Meca, E. G., & Ballesta, J. P. S. (2009). Corporate governance and earnings management: A meta-analysis.

Corporate Governance: An International Review, 17(5), 594-610. https://doi.org/10.1111/j.1467-8683.2009.00753.x

Odudu, A., Okpeh, A. J., & Okpe, U. J. (2016). Board Characteristics and Financial Performance of Deposit Money Banks in Nigeria. *International Journal of Business and Social Science, 7*(9), 159-173.

OECD. (2004). *Corporate governance definition*. Retrieved from http://stats.oecd.org/glossary/detail.Asp?ID=6778

Ongore, V. O., K'Obonyo, P. O., Ogutu, M., & Bosire, E. M. (2015). Board Composition and Financial Performance: Empirical Analysis of Companies Listed at the Nairobi Securities Exchange. *Intern. J. Econ. Finan. Issues, 5*(4), 23-43.

Roodposhti, R., & Chashmi, N. (2011). The impact of corporate governance mechanisms on earnings management. *Afri. J. Bus. Manag., 5*(11), 4143-4151.

Saleh, N. M., Iskandar, T. M., Rahmat, M. M. (2005). Earnings management and board characteristics: Evidence from Malaysia. *Journal Pengurusan, 24*, 77-103.

Sarikhani, M., & Ebrahimi, M. (2011). Corporate governance and earnings informativeness: Evidence from Iran. Intern. *Res. J. Finan. Econ., 65*, 43-50. https://doi.org/10.2139/ssrn.834124

Sekaran, U., & Bougie, R. (2010). *Research methodology for business: A skill building approach* (5th ed.). Australia: Wiley & Sons.

Wenyao, L., & Qin, L. (2008). *Board composition and earnings management.* Paper presented at the 4th international conference on wireless communications, networking and mobile computing, Dalian, China.

Xia, B., & Zhao, C. (2009). *Empirical research on the relationship between characteristics of supervisory board and earnings quality*. Paper presented at the second international workshop on knowledge discovery and data mining, Moscow. https://doi.org/10.1109/wkdd.2009.51

Yuemei, Z., & Yanxi, L. (2007). *The effect of the directorate characteristics on earnings management based on Chinese market data*. Paper presented at the international conference on wireless communications, networking and mobile computing, Shanghai, China.