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### Can Ownership Structure and Board Structure Affect Firm Performance? Jordanian Evidence

Suzan Abed<sup>1</sup>, Rawan Atwa<sup>2</sup> and Abeer Al-khoury<sup>3</sup>

<sup>1</sup>Applied Science Private University-Faculty of Economic and Administrative Science- Accounting Department. Email: [s\\_abed@asu.edu.jo](mailto:s_abed@asu.edu.jo)

<sup>2</sup>Yarmouk University-Faculty of Economic and Administrative Science- Accounting Department. Email: [rawan@yu.edu.jo](mailto:rawan@yu.edu.jo)

<sup>3</sup>Princess Sumaya University for Technology (PSUT) - King Talal Faculty of Business and Technology- Accounting Department. Email: [a.khoury@psut.edu.jo](mailto:a.khoury@psut.edu.jo)

#### ABSTRACT

We investigate the role of ownership and board structures on firm performance for non-financial Jordanian firms for the period from 2010 to 2014. We use a sample of 459 firm-year observations of non-financial companies listed at the Amman Stock Exchange. The results of the study reveal that there is a negative relationship between board size and firm performance, and some evidence of a positive relationship between board independence and firm performance. We also report that there is no association between ownership structure and firm performance. Furthermore, the results show a positive relation between firm size and firm performance, as well as a negative relation between debt ratio and firm performance.

**Keywords:** Jordan, institutional ownership, managerial ownership, board size, firm performance.

#### 1. INTRODUCTION

There has been a growing interest to investigate the effect of ownership structure and board structure on firms' performance. Most of the empirical studies have been related to developed markets such as the UK and the US with few studies investigating the emerging markets. For example, Chen et. al., (2010) report that corporate governance influence firm value in the US. The main theme of such studies is the agency theory that investigates the conflicts of interests between managers (agents) and principals (shareholders) (see, Berle and Means 1932; Jensen and Meckling, 1976). Recently, such debate has been shifted toward other markets to explain the role of ownership structure on firm performance. However, in Bahrain as an emerging market, ownership is more concentrated which results in having majority and minority shareholders

which may create a potential conflict that may affect firm performance (Khamis, 2015). From international context, La Porta et. al., (1998) show that firms would suffer from significant agency conflicts operating in countries with low level of legal protection and shareholder rights. Using a single country analysis, Al-Najjar (2011) detects that agency theory does stand in Jordan, and that institutional ownership has an impact on firms' financial policies. Bekiris (2013) examines the interrelation among ownership structure and board characteristics in Greek companies. He finds that independent directors are more likely to be hired by firms with higher institution ownership.

Most of the previous studies have concentrated on the role of ownership and board structures as the main governance mechanisms (Bekiris, 2013). One research theme examines the relation between ownership structure and firm performance (Demsetz and Villalonga, 2001). The investigation of ownership structure in developing countries has gain more attention recently. For example, Abu-Serdaneh et. al., (2010) examine the relation between institutional ownership and corporate performance and find a negative relation. Alternatively, another research has investigated the relation between board structure and firm performance (Bhagat and Black, 2000). The current study aims to explore the agency perspectives in Jordan within firm performance context. Jordan has started its ongoing economic restructuring process to simulate growth, reduce poverty, and improve the economy. In so doing, Jordan started the privatization process and developing the stock markets. However, the effectiveness of the governance practices needs to be evaluated (OECD, 2014). This study investigates the impact of ownership structure and corporate governance on the performance of non-financial Jordanian listed firms.

As argued by Chen and Al-Najjar (2012) internal corporate governance factors and ownership structure in Chinese firms might act as a substitute to each other. This study sheds more light on the two major shareholders in Jordan, managerial ownership and institutional ownership. Finally, it should be noted that the reforms of corporate governance in Jordan is still in an early stage and much work is needed to functionalize the role of each governance mechanisms (OECD, 2014). Hence, within Jordanian context, board structure is taken as a main determinant of corporate governance. Hence, we examine the role of board structure (board size and board independence) and ownership structure (managerial ownership and the institutional ownership) on firm performance.

The next Section, Section 2, highlights the theoretical framework and hypotheses development; Section 3 discusses the data and methodology; Section 4 reports the findings; Section 5 concludes of and provides recommendations.

## **2. THEORETICAL FRAMEWORK AND HYPOTHESES DEVELOPMENT**

Several studies have focused on how corporate governance mechanisms and ownership structure affect firm performance. It is usually suggested that good corporate governance practices help in improving firm value and performance. The main theory, here, is agency theory. Given information asymmetry does exist then there is a high likelihood for firms to face agency costs resulting from the conflict of interests between management and shareholders. Managers tend to work in opportunistic behaviour in order to increase their interests and enhance their positions (Jensen and Meckling, 1976). Nevertheless, agency conflicts can be mitigated with the existence of good corporate governance mechanisms.

Large shareholders key role in minimizing agency conflicts is well documented in the literature. For instance, it is argued that institutional owners is an important tool in firms' monitoring activities since such

investors control and manage “large amounts of investment funds” (Ozkan, 2006). Similarly, Jensen (1986), Pound (1988) and Tong and Ning (2004) argue that institutional investors have a key role in minimising agency costs and monitoring management. Al-Najjar (2014) documents a positive relation between board independence and firm performance for publically listed tourism firm within Middle Eastern countries context. In the same manner, Bhatt and Bhattacharya (2015) demonstrate positive relation between board size and firm performance of information technology sector in India. This study adopts the agency framework in associating board and ownership structures with firm performance.

### *The Construction of the Hypotheses*

This part of the study discusses our main hypotheses; we start with ownership structure and then board structure. Finally, firm specific factors (firm size and debt ratio), are demonstrated.

*Ownership structure:* Jensen and Meckling (1976) suggest that there is a converge of interest between managers and shareholders in the presence of high level of ownership. This is because with higher ownership level, directors can monitor management more efficiently and hence reducing agency costs and increasing firm performance. Shleifer and Vishny (1997) show some evidence that ownership concentration has a positive effect on performance. McConnell and Servaes (1990) provide evidence that firm performance and institutional ownership are positively correlated. Therefore, the previous empirical studies have provided evidence that the existence of institutional investors will improve firm value and performance.

Previous studies find mixed results in the relation between firm performance and managerial ownership. Morck et. al., (1988) investigate the effect of managerial ownership on company value in the US market and find no relationship between the two variables. However, Severin (2001) and Kumar (2003) document a positive relation between board ownership and firm performance. Other Studies find no relationship between board ownership and firm performance (Demsetz and Villalonga, 2001; Rowe and Davidson, 2002; Sulong and Nor, 2010; Khamis et. al., 2015). The above discussion supports the relationship between institutional ownership and managerial ownership on firm performance. Hence, we hypothesize that:

**H1a:** There is a positive relationship between institutional ownership and firm performance

**H1b:** There is a relationship between managerial ownership and firm performance

*Board Independence:* Agency theory suggests that independent directors have key monitoring activities compared to insider directors (Fama and Jensen, 1983). However, the role of board independence is controversial. For example, Dalton et. al., (1998) and Bhatt and Bhattacharya (2015) demonstrate that independent directors on the board are not associated with firm performance. Hu et. al., (2009) empirically examine the importance of board independence on firm performance. They report that in the presence of high ownership concentration, firms hire more “controlling directors” and less independent directors, and hence these independent directors were found not to operate effectively to improve firm performance. Fauzi and Locke (2012) document a negative relationship between board independence and firm performance. However, Yoshikawa and McGuire (2008) highlight that independent director can bring their knowledge and expertise to firms. Peng (2004) detects that using “institutional independent directors” positively influence firm performance. In addition, Chen et. al., (2006) detect that independent directors are active in minimizing fraud activities. Al-Najjar (2014) reports a positive relationship between board independence and firm performance using listed tourism related firms in a sample of five Middle Eastern countries. Accordingly, we hypothesize that:

**H2:** there is a positive relationship between board independence and firm performance

*Board Size:* The number of board members is considered to be one of the factors affecting firm's performance. Agency theory supporters propose that large size of the board will enhance firm value. That is, large boards are more efficient in firm monitoring by reducing CEO authority within the board and hence improving firm performance (Bertoni et. al., 2014). Coles et. al., (2008) provide evidence that there is a positive association between firm performance and board size. Additionally, Bhatt and Bhattacharya (2015) show that larger board size is positively related to firm performance in Indian Information Technology companies. In the same manner, Al-Najjar (2014) documents a positive relationship between board size and firm performance in tourism companies in five Middle Eastern countries (Bahrain, Egypt, Kuwait, Oman and Jordan). Conversely, Jensen (1986) proposes that small boards will improve co-ordination, communication and cohesiveness, leading to more effective management monitoring. This argument has been supported by different empirical studies that report firm value is positively associated smaller boards (Yermack, 1996; Eisenberg et. al., 1998). In the same manner, Yermarck (1996), Hossain et. al., (2001), Reddy et. al., (2008) and Guest (2009) find a negative relationship between board size and firm performance. Hence, given the contradicting results we posit that:

**H3:** There is a relationship between board size and firm performance.

*Firm-Specific Variables:* We control for firm size and debt ratio and discuss them without forming hypotheses as these are our controlled variables.

*Firm Size and Debt Ratio:* Al-Najjar (2014), among others, argues that larger firms can be seen as more diversified, if compared to their smaller counterparts, and hence they outperform small firms. Also, large firms can enhance their performance by utilizing their investment-opportunities and. Baek et. al., (2004) report a positive relationship between firm size and firm value. Chen et. al., (2010) document a positive association between size and performance. Hence, firm size will have an impact on firm performance. We measure firm size by the natural logarithm of total assets.

Controlling for debt ratio is one way to examine if creditors and lenders can minimise agency conflicts (Harvey et. al., 2004; Lins, 2003; McConnell and Servaes, 1995). Debt ratio is measured as the ratio of total debt to total assets. It is suggested that debt might help in improving firm performance (see, Chen et. al., 2010). Severin (2001) argues that debt ratio could be seen as a important factor that affect performance by reducing free cash flow. That is debt ratio play an significant role in the cost of borrowing, and hence affects the performance. Thus, debt ratio has an impact on firm performance.

### 3. DATA AND METHODOLOGY

#### Data

We aim to empirically examine the role of ownership and board structures on firm performance for the non-financial firms listed at the Amman Stock Exchange. The total number of industrial and service companies listed in the Amman Stock Exchange during 2014 is 118 companies. The final sample consists of 92 Jordanian Industrial and Service firms after excluding companies due to merger and acquisition and unviability of study information. Screening for the required data for board structure and ownership structure, we end with 459 non-financial firm- observations. Our period of analysis is 2010 to 2014.

Table 1 presents the descriptive statistics, the average of institutional ownership is 40%, indicating that 40% of the total outstanding shares are owned by institutional investors. For the managerial ownership, we report that 49.6% of the shares are owned by the board. On average 90.6% of the directors are independent. Finally, firms show weak average performance, for example 2.5% is the average ROE for the entire sample, and 2.7% is the average firm performance measured by ROA.

**Table 1**  
**Descriptive Statistics**

<i>Variable</i>	<i>Mean</i>	<i>Std. Dev.</i>	<i>Min</i>	<i>Max</i>
ROE	0.0248	0.184	-0.996	0.99
ROA	0.027	.105	-0.44	0.99
Institutional_ownership	0.4000	0.2855	0	0.986
Managerial_ownership	0.496	0.264	0	0.9595
Board_independence	0.906	0.104	0.4	1
Board_size	8.193	2.301	3	14
Debt	31.98	21.18	0.02	0.95
Firm_size	17.07	1.458	13.06	21.31

*Note:* ROE (Return on Equity) measured as net income to owners' equity ratio; ROA (Return on Asset) measured as net income to total asset ratio; Institutional\_ownership, is institutional ownership measured as number of shares owned by institutions to total shares. Managerial\_ownership is measured as the percentage of shares own by the board of directors. Board\_independence is board independence variable measured as independent directors divided by the total board size. Board\_size measured as total number of board member. Debt is total debt to total asset ratio, and Firm\_size is the natural logarithm of total assets.

Table 2 shows the correlation coefficients among the investigated independent variables, the table shows no high bi-variate correlations among the examined variables and thus there is no multicollinearity problem in our models.

**Table 2**  
**Correlation Matrix**

	<i>Institutional_ownership</i>	<i>Managerial_ownership</i>	<i>Board_independence</i>	<i>Board_size</i>	<i>Debt</i>	<i>Firm_size</i>
Institutional_ownership	1					
Managerial_ownership	0.2521	1				
Board_independence	0.2344	0.0142	1			
Board_size	0.0681	-0.0016	0.169	1		
Debt	0.1517	-0.0319	0.1022	0.0427	1	
Firm_size	0.3057	0.0338	0.1631	0.5049	0.3394	1

*Note:* ROE (Return on Equity) measured as net income to owners' equity ratio; Institutional\_ownership, is institutional ownership measured as number of shares owned by institutions to total shares. Managerial\_ownership is measured as the percentage of shares own by the board of directors. Board\_independence is board independence variable measured as independent directors divided by the total board size. Board\_size measured as total number of board member. Debt is total debt to total asset ratio, and Firm\_size is the natural logarithm of total assets.

## Methodology

To investigate how ownership structure and board structure affect firm performance, we employ cross-section time series analysis for our Jordanian non-financial firms for the period from 2010 to 2014, and hence, our model:

$$\begin{aligned} \text{Performance}_{it} = & \beta_0 + \beta_1 \text{Institutional\_ownership}_{it} + \beta_2 \text{Managerial\_ownership}_{it} \\ & + \beta_3 \text{Board\_independence}_{it} + \beta_4 \text{Board\_Size}_{it} + \beta_5 \text{Debt}_{it} \\ & + \beta_6 \text{Firm\_size}_{it} + \varepsilon_{it} \end{aligned}$$

where, Performance is defined in two ways: Return on Equity (ROE), measured as net income to owners' equity ratio, and Return to Asset (ROA), measured as net income to average asset ratio. Xu and Wang (1999) and Qi et. al., (2000) use the same definitions. Institutional\_ownership is measured by the number of shares owned by institutions to total number of shares, managerial\_ownership is measured by the percentage of shares owned by managers, board\_Size measured by number of directors in the board, board\_independence measured as the total number of independent directors divided by board size. Debt is measured by the total debt to total asset ratio, and firm\_size is measured by the natural logarithm of the total assets.

As a robust check, this study employs instrumental variables (IV) analysis with corporate governance variables as the main exogenous variables. It is argued that corporate governance characteristics in regression analysis might cause endogeneity issues (Hermalin and Weisbach, 1991). Thus, IV estimation techniques will provide robust findings.

## 4. RESULTS

The result of the study indicates that there is no relationship between institutional ownership and firm performance as reported in Table 3. This result contradicts the findings of Wei et. al., (2005) and H1a, but in line with the argument of Xu and Wang (1999). In addition, the result reports no significant association between firm performance and managerial ownership. This result is inconsistent with our hypothesis H1b and previous studies such as Severin (2001) and Kumar (2003). However, our result is in line with previous studies (Demsetz and Villalonga, 2001; Rowe and Davidson, 2002; Sulong and Nor, 2010; Khamis et. al., 2015).

As regards board structure, consistent with H2 there is some evidence of a positive relationship between independent directors and firm performance. This result indicates that independent directors in Jordan are seen as an effective monitoring tool and influence positively firm performance. This finding is in line with the role of board independence reported by previous studies (Peng, 2004; Yoshikawa and McGire, 2008). However, this result contradicts with the findings of Chen and Al-Najjar (2012). For Board Size, the results document a negative relationship with firm performance. This result is in line with H3 and previous studies (Yermarck, 1996; Hossain et. al., 2001; Reddy et. al., 2008; Guest, 2009). One explanation could be related to the fact that small board size enhances communication and coordination between them. Finally, firm performance is improved by large size and lower debt ratio.

We conclude from the results of Table 3 that institutional ownership has no impact on firm performance. Hence, institutional ownership might not be seen as a good governance tool to maximize firm performance by minimizing agency conflicts. Or it cannot be seen as a tool to transmit information

to outside shareholders and as a result mitigating information asymmetry (between managers and other outside stakeholders). Finally, the study supports the role of board structure in corporate governance within the Jordanian context. The result shows that small board size benefits firms by providing access to all available resources and passing information easily among different stakeholders.

Models 3 and 4 report the results of the ROA models. There is a significant negative relationship between board size and firm performance. This is in line with the previous findings. Thus, the important role of board size in firm performance is confirmed. This indicates that small boards can be seen as an effective tool to monitor firms' performance. As regards institutional and managerial ownership, there is no evidence of a significant impact of both institutional and managerial ownership on firm performance. This indicates that the institutional ownership is not a significant tool to monitor firms' performance.

**Table 3**  
Cross section-time series regression analysis

	Model 1		Model 2		Model 3		Model 4	
	ROE				ROA			
	Coef.	Std. Err.	Coef.	Std. Err.	Coef.	Std. Err.	Coef.	Std. Err.
Institutional_ownership	0.0147	0.1285	0.0063	0.3122	-0.003	0.0545	0.0034	0.0220
Managerial_ownership	0.0584	0.1045	0.0327	0.1052	-0.0012	0.0445	-0.0066	0.0227
Board_independence	0.6930**	0.3066	0.6791**	0.3112	0.0655	0.0131	0.0692	0.0575
Board_size	-0.0437**	0.0214	-0.0213*	0.0219	-0.0380***	0.0091	-0.040***	0.0036
Debt	-0.0202***	0.0052	-0.0214***	0.0054	-0.0011	0.0022	-0.0054	0.0014
Firm_size	0.151***	0.0501	0.111**	0.0547	0.0967***	0.0212	0.1042***	0.0098
_cons	-2.20319**	0.9283	-1.495	1.0122	-1.312***	0.393	-1.455***	0.1265
Year	No		Yes		No		Yes	
Number of firms	92		92		92		92	
Number of obs.	459		459		459		459	

Note: ROE (Return on Equity) measured as net income to owners' equity ratio; ROA (Return on Asset) measured as net income to total asset ratio; Institutional\_ownership, is institutional ownership measured as number of shares owned by institutions to total shares. Managerial\_ownership is measured as the percentage of shares own by the board of directors. Board\_independence is board independence variable measured as independent directors divided by the total board size. Board\_size measured as total number of board member. Debt is total debt to total asset ratio, and Firm\_size is the natural logarithm of total assets.

For robustness check the IV models are reported in Table 4 where the main exogenous factors are board size, board independence, institutional ownership and managerial ownership. Our findings show that there is a negative relationship between board size and firm performance as well as a positive relationship between board independence and firm performance. In addition, the study could not find any significant association between the ownership structure factors and firm performance. These results are consistent with the findings reported in Table 3 and show the robustness of our results. The Sargen test reported in Table 4 is insignificant in all our models at 5% significant level and hence our instruments used in these models are valid.

The results reported in Tables 3 and 4 show that board size and board independence have an impact on firm performance in Jordanian non-financial firms. However, we find no evidence of any significant

association between the investigated ownership structure factors (both institutional and managerial ownership) and firm performance.

**Table 4**  
**IV Analysis**

	<i>Model 1</i>		<i>Model 2</i>		<i>Model 3</i>		<i>Model 4</i>	
	ROE				ROA			
	<i>Coef.</i>	<i>Std. Err.</i>	<i>Coef.</i>	<i>Std. Err.</i>	<i>Coef.</i>	<i>Std. Err.</i>	<i>Coef.</i>	<i>Std. Err.</i>
Institutional_ownership	0.0271	0.0637015	0.0302	0.0643	0.0036	0.0219	0.0037	0.0220
Managerial_ownership	-0.0488	0.0656375	-0.0555	0.0665	-0.0012	0.022	-0.0016	0.0227
Board_independence	0.2710142*	0.1671	0.271*	0.1683	0.0609	0.0574	0.0610	0.0575
Board_size	-0.0273**	0.0107	-0.02695**	0.0108	-0.0117***	0.0036	-0.0116***	0.0036
Debt	-0.0175***	0.00424	-0.0175***	0.0043	-0.0053***	0.0014	-0.0053***	0.0014
Firm_size	0.1362***	0.0285	0.1362***	0.0287	0.0516***	0.009	0.0516***	0.0098
_cons	-1.7556***	0.3647	-1.7136***	0.36948	-0.6438***	0.1256	-0.636***	0.1265
Year-dummies	No		Yes		No		Yes	
Hausman test	57(0.00)		59(0.00)		9.4(0.00)		9.39(0.00)	
Sargan test	4.00(.06)		3.8(0.058)		0.74(0.39)		0.85(0.36)	

*Note:* ROE (Return on Equity) measured as net income to owners' equity ratio; ROA (Return on Asset) measured as net income to total asset ratio; Institutional\_ownership, is institutional ownership measured as number of shares owned by institutions to total shares. Managerial\_ownership is measured as the percentage of shares own by the board of directors. Board\_independence is board independence variable measured as independent directors divided by the total board size. Board\_size measured as total number of board member. Debt is total debt to total asset ratio, and Firm\_size is the natural logarithm of total assets.

## 5. CONCLUSION AND FURTHER STUDIES

This study aims at investigating the role of ownership structure (managerial ownership and, institutional ownership) and board structure (board size and board independence) on firm performance. Our sample includes 459 firm-year observations for non-financial Jordanian firms for the period from 2010 to 2014. We report that there is no relationship between ownership structure and firm performance, indicating that ownership structure is not seen as an active governance tool to enhance firm performance. As regards board structure, our findings support the previous literature for the active role of independent directors. The study also shows that there is negative impact of board size on firm performance. Our results are robust after using the IV models.

We recommend further studies in the relationship between corporate governance and firm performance using other emerging markets by employing different governance factors such as: board sub-committees and their meetings.

Finally, the study has different implications for policy makers in Jordan as our results show the importance of board structure on firm performance, and hence further rules and regulations should be implemented to identify the role of board characteristics in Jordanian listed firms. The other important issue the policy makers need to direct their attention to improve the investment environment in Jordan. Thus, institutional investors would be more engaged in firms' management.



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