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The Impact of Corporate Governance Application on Financial Performance of the New Ventures Jordanian Companies

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Abstract
This Study aims to investigate the impact of the application of Corporate Governance (CG) rules on the performance of Jordanian listed companies that consider new ventures by analyzing their annual reports for the year 2013 produced by targeted companies or provided by Amman Stock Exchange (ASE). To achieve the objectives of the study, this research adopted a survey to find the extent of application of the rules of CG guidelines issued by the Amman Securities Commission (ASC) as an indicator to measure the application of CG rules. The findings of this study indicate a strong commitment to CG and all targeted companies disclosed information about the Board of Directors of a shareholding company. In regards to General Assembly meeting, a moderate commitment was indicated. Furthermore, the results of this study indicate a weak application for CG relate to the Shareholders' Rights (lowest among all investigated rules), and the commitment to issues related to **Transparency and disclosure** is still weak. Finally, the results show that no associations are exist between the company`s performance "ROA, ROE and EPS" and the reporting of the company CG application.
Keywords: Corporate Governance; Governance Practices; Corporate Governance Index; Financial Performance; New Ventures; Jordan.

1. Introduction

Corporate governance is more broadly defined as a set of relationships between a company's management, its board, its shareholders and other stakeholders. It is an instrument to obtain business collectivity and transparency and to promote economic growth. It especially protects investors due to well-functioning financial markets. With the globalization, mobilization of capital, and integration of financial markets forced countries for effective corporate governance standards (Buiten, 2012).

Much attention has been dedicated by researchers, in the last two decades, to study Corporate Governance among corporations. Most of the studies were conducted in developed countries with only a few being undertaken in developing countries (Bawaneh, 2011) and no studies conducted in Jordanian new ventures.

Academics and business managers have noticed how corporate governance has been transformed from an irrelevant and doubtful idea to a high-ranking topic on research agendas (Rosamaria and Robert, 2011). Corporate Governance has been the subject of research interest in the social sciences since the mid-1900s (Christofi et al., 2012). Recently, the concept of corporate governance became more significant and controversial, due to accounts of fraud, accounting scandals, inside trading, excessive compensation, and other failures of the governance, particularly in the developed countries (Benea, 2012). Corporate failures prompted interest in the link between corporate governance and firm performance. The relation between corporate governance and firm performance has been the subject for many extensive studies in the last decade (Buiten, 2012).

In the last decade, considerable efforts have been given by public and private bodies to the corporate governance issues in Jordan. This research examines the extent to which do business entities in Jordan engage in corporate governance issues on the national level. To come into that end, the current study investigates the level of adopting and implementing the CG practices by the Jordanian public shareholding companies that consider being new ventures through examining the CG reported information within their annual reports and the information provided by ASE.

In addition to this introduction, the flow of this paper is divided into several parts as follows: the research problem, the research questions; an overview of CG reporting and rules; previous literature on CG application; methodology and method which also describes the data collection process; the descriptive analysis results; and finally results of the analytical statistics along with conclusion and recommendations.

1.1 The Research Problem

The deterioration of Business organizations asset portfolios largely due to distorted credit management was one of the main structural sources of the world's financial crisis (Fries et al., 2002). To a large extent, this problem was the result of poor and lack corporate governance codes in many countries and mainly in banking institutions and industrial groups (Schjoedt, 2000) and observed that this poor corporate governance, in turn, was very much attributable to the relationships among the government, banks and big businesses as well as the organizational structure of businesses (see also, Ranti, 2011).

It has been argued that annual reports considered as one of the tools that help organizations to fulfill their duties towards Corporate Governance. In this context, there are always calls on the national level for concerted efforts of all members of the society and organizations to contribute for the commitment of CG (Al-Hamadeen and Badran, 2014).

As Jordan considered part of developing countries, it serves as a model to explore the extent to which a purse companies contribute to the general conditions of the corporate governance system and the requirements of those countries.

1.2 The Research Questions

The key motivation for carrying out this research is to measure responsiveness of the new venture of Jordanian industrial businesses for CG challenges and needs. To this end, the current research study addresses the following research questions

1. To what extent do companies report information related to CG issues
2. What factors (among company's performance indicators) are associated with the CG application?

2. An Overview and rules of Corporate Governance

Corporate Governance has been the focus of reform proposals over the past three decades, as successive waves of corporate problems – some appearing in isolation others made obvious by difficult economic times have yielded a variety of recommendations, with recovery in economic growth and corporate profits, however, reform proposals have often been pushed aside. While certain modest improvements might occur, the commitment to sweeping and sustained reform within the global corporate system has not yet appeared (Ezzamel, 2006).

Defining corporate governance can be pretty obvious, as it is just about proper governance of corporations. Corporate Governance has multiple definitions that depend of the view on the world that one has. For example, Shleifer and Vishny (1997) define corporate governance in terms of economic interest of the participants. They refer to corporate governance as a way by which suppliers of finance to corporations "… assure themselves of getting a return on their investments."

Zingales (1998) defines this quite similarly as he defines corporate governance as" … the complex set of constraints that shape the ex-post bargaining over the quasi-rents generated by the firm."

Gillan and Starks (1998) define corporate governance as "the system of laws, rules and factors that control operations at a company." According to Gillan (2006) researchers often view corporate governance as mechanisms that fall into two groups: the group internal and the group external to the firms. Gillan (2006) used this last definition to design a framework of corporate governance. The broad perspective of what constitutes corporate governance incorporates elements that had not previously been seen as being part of corporate governance, but at a minimum affects corporate governance and thus is included in their framework. The internal as well as the external factors are described below to get familiarized with the most important elements that constitute corporate governance.

2.1 Rules of Corporate Governance

Institutional commitment governance indicates that the company is responsible to disclose annual report to individuals explaining its corporate committees and whether they apply it or not plus explaining the reason. The company have to set up a committee consisting of Chairman of the board and two non-executive members to prepare and update the governance guide. Where should be a clear division of responsibilities between the chairman and Board of Directors; the board's role is to provide entrepreneurial leadership of the company and effective controls which enables risk to be assessed and managed. The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role. At last, there should be at least three non-executive members for the running of the company's business. Overall, the board should present a fair, balanced and understandable assessment of the company's position and prospects; also they should establish formal arrangements for considering how they should apply the corporate reporting, risk management and internal control principles and for maintaining an appropriate relationship with the company's auditors.

Environment of internal control in accordance to the company's policy is that at least two members of audit committee should have relevant financial management qualifications and expertise. Internal auditor is responsible for studying and evaluating the internal control and auditing procedures, discussing matters related to the work of the external auditor including his observations, suggestions, pursuing the level of responsiveness of the company`s management and submitting recommendations to the board of directors. External auditor is responsible in performing the duties assigned to him independently monitoring the bank's operations attend meetings of the company's general meetings.

The company should take appropriate measures to ensure that shareholders enjoy their rights in a manner that would achieve justice and equality without discrimination. For example: Access to the company`s general assembly meetings, priority to subscribe in any new share issuance by the company, before these shares are offered to other investors. The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company, and annual report should be presented on the website.

3. Previous Literature on Corporate Governance

In addition to numerous surveys been conducted by professional bodies, CG application has been widely examined within the accounting and business literature. Guan et al., (2007), in a stakeholders-focused attempt, find that to protect investors' rights and enhance information transparency, the regulatory authorities of securities markets and information intermediaries have exerted great effort to advocate corporate governance, thus lessening the occurrence of adverse selection and agency problems as a result of the information asymmetry. Corporate governance has been studied as a mechanism which affects corporate disclosure. Transparency, openness, disclosure and trust, which form the integral part of corporate governance, can exert pressures to improve financial performance.

In the same vein, Kent and Stewart (2008) examine the association between corporate mandatory disclosure and corporate governance quality by using a number of sentences explaining how the transition to the Australian Equivalent of International Financial Reporting Standards (AIFRS) is being managed and an index of the number is changed to accounting policies discussed in the note to the account pertaining to the transition to AIFRS. They found that corporate disclosure quality is positively related to board size and audit firm size; on the other hand, there is no relation between board committee independence and corporate mandatory disclosure.

Garcia &Ballesta (2010) applied Meta -analysis to a sample of 27 empirical studies to clarify the association of board independence and ownership concentration with corporate voluntary disclosure. They examine whether various in results are attributable to the difference in the corporate governance system, the investor protection right and the measurement of governance variables. They find that there is a positive association between board independence and corporate voluntary disclosure that only occurs in countries with higher investor protection right.

In more focus in the firm profitability and state owner ship Shen and Lin (2009) studied the relationships between firm profitability, state ownership, and top management turnover at partially privatized firms in China and they find that firm profitability and state ownership are negatively related to top management turnover only when firm profitability is below target (measured by industry median). They also find that top management turnover has a positive impact on subsequent firm profitability when it occurs under performance below target, but has a negative impact when it occurs under performance above target. In addition, they report that top management turnover under performance below target has a positive impact on subsequent firm profitability when the state is not the largest shareholder, but has no impact when the state is the largest shareholder.

In more focus to the banking sector, Bawaneh (2011) study seeks to understand how Jordan banking sector is affected by the Corporate Governance (CG requirements released by Basel Committee on Banking Supervision (BCBS) and Organization for Economic Cooperation and Development (OECD). The study reveals that Jordan Banking Sector has been paying CG a great deal of attention. Therefore, the Central Bank of Jordan (CBJ) issued Bank Directors Handbook of CG which has been developed with the objectives of enhancing the CG of Jordanian Banks. Further to issuing the Handbook, the CBJ is continuing its efforts to enhance CG by preparing the CG code which is intended to promote international best practice in the CG of Jordanian Banks, and asked each bank to keep this code under review and be developed and amended as required from time to time to meet the changing needs and expectations of the bank and the marketplace. As a result, banks in Jordan comply with CG requirements by acting in accordance with a request from the CBJ based on BCBS and OECD guidelines and requirements which enhance the CG procedures. Therefore, CG continues to gain attention and importance from parties concerned in Jordan but many steps need to be done in the future.

In the same context, Bino and Omar (2012) Study based on a sample of 14 banks listed on Amman Stock Exchange market over the period 1997 to 2006 , this study investigates the relationship between corporate governance namely: ownership structure , board composition , and board size, and Bank performance using a linear regression analysis. The results show that ownership structure and board composition have a strong impact on the bank performance. Results indicate that banks with institutional majority ownership have the highest performance and that as manager's and board member's ownership percentages increase the bank becomes more efficient, surprisingly board size (number of members) has no effect on bank's performance.

In an attempt to explore the corporate governance quality, Kalezic (2012) studied the quality of corporate governance practice in Montenegrin corporate and banking system. Based on the OECD questionnaire on corporate governance, they surveyed 43 joint stock companies in Montenegro, with the aim of construing the corporate governance rating (CGR) for Montenegro companies and banks. The CGR provided a better prospective on the difference of corporate governance mechanisms developed in parallel with the corporate and banking systems of Montenegro. Using OLS prohibit and logic models, they show that the general corporate governance practice in the banking system can be considered better compared to the corporate sector .however, the difference is not significant.

In Jordanian literature, Alhazaimeh et al., (2014) suggested that In the new economy, companies try to convey to their stakeholders that they are a good investment and Attempt highlight the good value of the company via disclosure of pertinent information in the annual reports. This paper investigates the relationship between corporate governance and ownership structure on voluntary disclosure, with a particular focus on variables affecting in voluntary disclosure of listed companies in the Amman Stock Exchange (ASE). By using a dynamic panel system GMM estimation for the period 2002-2011, they studied 72 Jordanian listed companies at ASE during 2002-2011 and had shown a significant degree of voluntary disclosure in line with greater corporate governance awareness and implementation in Jordan. In particular, they found board activity, foreign ownership, non –executive directors and block holder ownership to be significant in influencing voluntary disclosure. Finally, found that the voluntary disclosure in the annual reports does potentially affect the market capitalization.

4. Methodology, Methods and Data Collection Process

Based on Chua's (1986) classification of accounting research, this study is a mainstream one. In this regards, attention will be given to analyze the phenomena through an objective quantitative oriented technique (Al-Hamadeen and Badran, 2014). For the purpose of achieving the research objectives, this study applies the content analysis on the corporate websites to measure the nature of each company's CG application.

In terms of the methods being employed in this research, content analysis is utilized to extract data from two different sources: one relative to CG data (from the annual and reports produced by the targeted companies) and another that provided financial data (related to the Financial performance of the reporting companies based on information provided by ASE). In order to achieve objectives of the study, a research index including 17 items was applied to annual reports of 37 companies for the year 2013 (see appendix 1).

Given the fact that this study examines the level of CG application in annual reports of the new ventures Jordanian listed companies in Amman Stock Exchange (ASE) for the year 2012, information provided by the Jordanian Securities Commission (JSC) indicated that there were 37 companies listed on ASE that of age 6 years or less as of December 2012. All of these reports were subject to analysis by using the research Index.

5. Results and Analysis

This section provides results revealed on this research. Attention in this regard is given to highlight two types of results – based on the research questions, these include: descriptive analysis, and hypotheses testing as follows.

5.1 Descriptive Analysis

In this section, attention is given to the CG disclosure practices. Results presented here show the level of adoption of each element of CG by Jordanian new ventures listed companies (according to the research Index – see Appendix 1) and its percentage. Overall, the companies disclosed approximately 32.8% of the items identified in the current research Index. Nevertheless, on the forthcoming sub-sections results are presented separately for each of the five CG rules adopted on this research.

A. **: About the Commitment to Corporate Governance**

In this section attention is given into the commitments to the CG practices. Results presented here shows the level of adoption of commitment to each rule by the new ventures Jordanian companies (according to the research index) and its percentage. Table 1 exhibits the results of this section.

Table 1: General Commitment to CG

Rule 1: Disclosure about the Commitment to Corporate Governance:		**Frequency**	**Percentage**
1.1	The company disclosed in an annual basis publicly reports. Its compliance with the Code, where necessary Detailing how each provision of the Code has been implemented and, where relevant, where and why the company`s executive management has adopted procedures that are different from those recommended by the Code.	30	81.08%
1.2	The Company has formed a corporate governance committee of the Board, comprising the Chairman of the Board and two of the non-executive Directors, to direct the preparation, updating, and implementation of the Code.	6	16.22%
Average application for the rule			48.65%

Table 1 shows that the application level ranging from 16.22% to 81.08%. The highest level of this section was that 30 companies disclosed in an annual basis publicly reports. Its compliance with the rule, where necessary detailing how each provision of the Code has been implemented and, where relevant, where and why the company`s executive management has adopted procedures that are different from those recommended by the Rule.

On the other hand only 6 Companies had formed a corporate governance committee of the Board, comprising the Chairman of the Board and two of the non-executive Directors, to direct the preparation, updating, and implementation of the Rule.

B. About Board of Directors of a Shareholding Company

In this section attention is given into the disclosure about the board of directors practices, this rule have the highest level of disclosure comparing by the rest of the rules where the level of this rule disclosure is 56.76%. Table 2 exhibits the results of this section according to the research index.

Table 2: **Board of Directors of a Shareholding Company**

Rule 2 :The Board of Directors of a Shareholding Company		**Frequency**	**Percentage**
2.1	**The names and qualifications of the Board of Directors**	37	100%
2.2	Committees Formed by the Board of Director	16	43.24%
2.3	Meetings of the Board of Directors.	10	27.03%
Average Application for the rule			56.76%

Table 2 shows that the application level ranging from 27.0% to 100%. The key finding in this section is that all the companies "37" that included in the study disclosed information about the names and qualifications of the board of director's members and this is due to the company's disclosure law which requires from the companies to put separate part in the annual report about the members of the Board of Directors. Another key result is that 43.24% of the companies disclosed information about the committees that formed by the board of directors and most of them only has an audit committee.

C. **About General Assembly Meetings**

In this section attention is given into the disclosure about **General Assembly Meetings**. Table 3 exhibits the results of this section.

Table 3: **General Assembly Meetings**

Rule 3 : General Assembly Meetings		**Frequency**	**Percentage**
3.1	**The general assembly is composed of all shareholders who have the right to vote.**	14	37.84%
3.2	**The general assembly shall hold an ordinary meeting at least once a year.**	15	40.54%
3.3	**The board of directors shall announce the date and place of the general assembly meeting at least twice in three local daily newspapers**	5	13.51%
Average application for the rule			30.63%

Table 3 shows that the application level for this rule ranging from 13.51% to 40.54%. The highest level of this section was that 15 companies disclosed information about its general assembly and that it shall hold an ordinary meeting at least once a year.

On the other hand, the lowest section is that only 5 companies disclosed information about the commitment to announce the date and place of the general assembly meeting at least twice in three local daily newspapers and this may be due the cost of doing this.

D. About Shareholders' Rights

In this section attention is given into the disclosure of Shareholders' Rights, this rule have the lowest level of application comparing by the rest of the rules where the level of this rule application is only 11.71%. Table 4 exhibits the results of this section.

Table 4: **Shareholders' Rights**

Rule 4 : Shareholders' Rights		**Frequency**	**Percentage**
4.1	The company disclosed that it announced that it will publish its annual reports before 3 weeks from the publication date	5	13.51%
4.2	the company maintains a policy to communicate with its shareholder to see their Complaints	4	10.81%
4.3	Discussing the company's performance and its plans for the coming period with the board of director	4	10.81%
Average Application for the rule			11.71%

Table 4 shows that the application level of this rule ranging from 10.81% to 13.51%. The results of this table shows low level of commitment of the Jordanian new ventures to shareholders rights; only 4 companies disclosed information about whether the company maintains a policy to communicate with its shareholder to see their Complaints and about its Discussing the performance and its plans for the coming period with the board of director. Also only 5 companies mention their commitment to it announced that it will publish its annual reports before 3 weeks from the publication date.

E. Transparency and Disclosure

In this section attention is given into the commitment to the **Transparency and Disclosure. Table 5 shows the results of this section.**

Table 5: **Transparency and disclosure**

Rule 5 : Transparency and disclosure		**Frequency**	**Percentage**
5.1	**The company disclosed information related to social activities to the community.**	8	21.62%
5.2	**The company shall use its internet web-site to enhance disclosure and transparency, and to provide information.**	3	8.11%
5.3	**The Audit Committee and its duties**	13	35.14%
Average Application for the rule			21.62%

Table 4 shows that the application level for this rule ranging from 8.11% to 35.14%, where 13 companies disclosed information about the audit committee and its duties. And only 21.62% of the companies disclosed information about its activities related to the community.

The lowest percentage is that only 8.11% (3 companies) disclosed information about their using of an internet web-site to enhance disclosure and transparency, and to provide information.

5.2 Hypotheses Testing

For the purpose of performing analytical statistics, three factors have been identified as potential independent variables namely: ROA, ROE, and EPS. These three factors are used as independent variables to test whether or not there is a significant relationship between the company`s performance and the level CG application of its five Rules.

Drawing upon the relevant surveys and literature on CG application, the following main hypotheses is developed in this study:

H0: There is no association between the company`s performance “ROA, ROE, EPS” and the level of CG application.

H1: There is an association between the company`s performance “ROA, ROE, EPS” and the level of CG application.

To explore which of the four independent variables have a significant association with each dimension of the disclosure, Chi-Square used as a statistical tool to test the research hypotheses at 5% ($\alpha = .05$) level of significance. There is no generally accepted method to accumulate chi-square results for several items within one dimension; therefore, number of significant relationships related to each examined factor will be used as a rule to accept/reject the tested hypotheses. Table 6 demonstrates results of the statistical tests (P values) of the Pearson’s chi-square test – Independent variables versus Dimensions of CG.

Table 6: **Pearson's chi-square test – Independent variables versus Dimensions of CG**

P values of the Pearson's chi-square test – Independent Variables versus the Commitment to Corporate Governance			
Independent Variables	**Dependent Variables**		
	1.1	**1.2**	
ROA	0.48	0.33	
ROE	0.37	0.37	
EPS	0.43	0.36	
P values of the Pearson's chi-square test – Independent Variables versus the Board of Directors of a Shareholding Company			
	2.1	**2.2**	**2.3**
ROA	-----	0.44	0.45
ROE	-----	0.47	0.45
EPS	-----	0.65	0.35
P values of the Pearson's chi-square test – Independent Variables versus the General Assembly Meetings			
	3.1	**3.2**	**3.3**
ROA	0.53	0.52	0.53
ROE	0.47	0.47	0.37
EPS	0.36	0.67	0.15
P values of the Pearson's chi-square test – Independent Variables versus the Shareholders' Rights			
	4.1	**4.2**	**4.3**
ROA	0.53	0.33	0.57
ROE	0.37	0.38	0.37
EPS	0.34	0.26	0.98
P values of the Pearson's chi-square test – Independent Variables versus the Transparency and Disclosure			
	5.1	**5.2**	**5.3**
ROA	0.61	0.33	.42
ROE	0.51	0.37	0.37
EPS	0.71	0.53	0.42

In order to investigate whether relationships exist between ROA,ROE and EPS of the reporting company and CG application (Hypothesis 1), 42 chi-square tests were carried out. The results indicate that zero tests out of 42 are statistically significant at the 0.05 sig. level. Overall, this result suggests that there is no significant relationship exists between ROA, ROE and EPS with the level of CG application (all rules aggregated). Subsequently, the first null hypothesis is accepted and the alternative one is rejected.

6. Conclusion and Recommendations

Based on the research results discussed above (including descriptive and analytical), the current study found that there are variation between the reporting companies when it comes to level of CG rules applications.

With respect to the CG dimensions being disclosed on the annual reports of the Jordanian new ventures that are less than 6 years old as mentioned in the previous literature, the application level about the **Board of Directors** (with almost 58.2% of the items included under this dimension were detected). One of the key results revealed on the current research, is the continued weak application related to the Shareholders' Rights (lowest among all investigated rules), with only – in average 11.71% of the investigated items were disclosed. It should be indicated that the commitment to issues related to **Transparency and disclosure** is still weak, with only 21.6% of the targeted items were disclosed. Finally, the results show that almost 30.6% of the targeted items of labor and employees **General Assembly Meetings** were disclosed in 2012, and Disclosure about the general commitment to CG was 48.65%.

Also the study indicates that no associations are exist between the company`s performance "ROA, ROE and EPS" and the level of companies' CG application (aggregated rules).

The study suggests some recommendations that may help in the process of improving corporate governance application such as: increase the role of the shareholders and their interaction with the management of the company; the shareholders may actively exercise their rights and use their influence resulting in the management protecting the interests of the shareholders and ensuring an appropriate and balanced development of the company both in the short and the long term.

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Appendix 1: **Research Index**

<u>Rule 1: Commitment to Corporate Governance:</u> 1.1 The company disclosed in an annual basis publicly reports Its compliance with the Code, where necessary Detailing how each provision of the Code has been implemented and, where relevant, where and why the company`s executive management has adopted procedures that are different from those recommended by the Code. 1.2 The Company has formed a corporate governance committee of the Board, comprising the Chairman of the Board and two of the non-executive Directors, to direct the preparation, updating, and implementation of the Code.
<u>Rule 2 :The Board of Directors of a Shareholding Company</u> **2.1 The names and qualifications of the Board of Directors** 2.2Committees Formed by the Board of Director 2.3 Meetings of the Board of Directors
<u>Rule 3: General Assembly Meetings</u> **3.1. The general assembly is composed of all shareholders who have the right to vote.** **3.2. The general assembly shall hold an ordinary meeting at least once a year,** **3.3. The board of directors shall announce the date and place of the general assembly meeting at least twice in three local daily newspapers**
<u>Rule 4: Shareholders' Rights</u> 4. 1The company disclosed that it announced that it will publish its annual reports before 3 weeks from the publication date 4.2 the company maintains a policy to communicate with its shareholder to see their Complaints 4.3 Discussing the company's performance and its plans for the coming period with the board of director
<u>Rule 5: Transparency and Disclosure</u> **5.1The company disclosed information related to social activities to the community.** **5.2The company shall use its internet web-site to enhance disclosure and transparency, and to provide information.** **5.3The Audit Committee and its duties**
<u>6. Performance</u> 6.1 ROA 6.2ROE 6.3EPS