

## The Effect of Corporate Governance on Operating Performance of Jordanian Manufacturing Companies: Evidence from Amman Stock Exchange

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### ABSTRACT

This study empirically examines the relationship between corporate governance mechanisms and firm performance using Return on Assets, Return on Equity, Total Assets Turnover ratio and Inventory Turnover ratio as performance measures. The population of this study consists of manufacturing companies listed in the Amman stock exchange; the total number of companies was 94 manufacturing companies. A sample of 69 industrial companies listed in Amman stock exchange for a period of five years from 2005-2009 are examined. Panel data methodology is employed; the method of analysis is multiple regressions and the method of estimation is OLS. This study mainly studied the effect of largest shareholders, foreign ownership, and state ownership, the separation between chairman of the board and the Chief executive officer (CEO) and the total number of the board members. The results of the study revealed that the performance of the companies measured by Return on Assets, Return on Equity, Total Assets Turnover and inventory turnover ratio is significantly positively affected by the corporate governance mechanisms. Further investigation is recommended to study the effect of other corporate governance mechanisms, the regulatory bodies should be aware of duality between CEO and chairman, and finally the corporate governance principles should become mandatory due to their importance.

**Keywords:** Corporate Governance, Performance, Amman Stock Exchange.

### INTRODUCTION

The relationship of agency is one of the oldest and most common problems researched on the accounting theory. Based on the theory, a conflict of interests between managers and shareholders causes managers to take actions that are costly to shareholders. Contracts cannot prohibit this harmful activity if shareholders are unable to observe managerial behavior directly. Agency theory provides a framework to explain how to create an effective monitoring and incentive scheme under uncertainty and incomplete information (Jensen and Meckling, 1976).

In particular, agency theory suggests that a better-governed firm should have better performance and higher valuation due to lower agency costs. This prediction is supported by many empirical studies. For example, Gompers, Ishii, and Metrick (2003), found that better

corporate governance is associated with higher firm valuation as measured by Tobin's Q. Moreover, Brown and Caylor (2006, 2009) found that better-governed U.S. firms have higher return on equity (ROE), higher return on assets (ROA), and higher Tobin's Q. In addition, Dittmar and Mahrt-Smith (2007) found that good corporate governance has a substantial positive impact on U.S. firms' value.

Recently corporate governance become a main concern to academic and policy circles for many reasons, the most important reasons are: the recent financial crisis, firms increasing in size, complexity of allocation in capital due to liberalization, increase competition, and market risks (Claessens and Yurtoglu, 2013).

It is widely known that corporate governance in developed markets organizations differs from governance in emerging markets organizations (Bebchuk and Hamdani, 2009). Moreover, corporate governance differs among several emerging markets (Durnev and Fauver, 2007). Within a given country, corporate governance may depend on firm characteristics (Bruno and Claessens, 2010; Demsetz and Lehn, 1985). However, little facts about the degree to which broad corporate governance

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principles can be applied across countries, or across firms within a country is acknowledged. Thus, if there is sufficient harmony, “across the board” rules can be adopted to both within and across countries, even if they do not perfectly fit every firm or every country.

The purpose of this research is to examine the effect of the corporate governance mechanisms on the operating performance of the manufacturing companies listed in the Amman stock exchange.

### **The Problem Statement**

Many dimensions of corporate governance and monitoring mechanisms are presented in previous literature, this paper will focus on specific corporate governance mechanisms (specifically: ownership structure, board size, separation between chairman and CEO) to study their effect on the performance. The investigation is mainly guided by the following general four questions:

- Do the corporate governance mechanisms affect the return on assets of the manufacturing companies listed in the Amman Stock Exchange?
- Do the corporate governance mechanisms affect the return on equity of the manufacturing companies listed in the Amman Stock Exchange?
- Do the corporate governance mechanisms affect the assets turnover ratio of the manufacturing companies listed in the Amman Stock Exchange?
- Do the corporate governance mechanisms affect the inventory turnover ratio of the manufacturing companies listed in the Amman Stock Exchange?

### **Importance of the Study**

An impressive set of recent papers has considered several dimension measures of corporate governance, and studied the impact of these governance measures on firm performance, but most prior research focuses on corporate governance in developed market. Studies in emerging markets, in general, and those related to Jordan in particular are relatively few and have mixed results and further investigation is needed to determine the relationship between the corporate governance and performance based on archival data. This research is of immense value to regulators, shareholders, industrial companies, academics, and other relevant stakeholders. The study provides an insight into understanding the level of compliant of industrial Jordanian companies with corporate governance, and the effect of that on

performance.

### **The Objective of the Study**

This study tries to explain the effect of corporate governance mechanisms on the performance of the manufacturing companies listed in the Amman Stock Exchange during the period between 2005 and 2009. This study mainly has the following objectives:

- Examine the effect of corporate governance mechanisms on the return on assets of the manufacturing companies listed in the Amman Stock Exchange?
- Examine the effect of the corporate governance mechanisms on the return on equity of the manufacturing listed in the Amman Stock Exchange?
- Examine the effect of corporate governance mechanisms on the total assets turnover ratio of the manufacturing listed in the Amman Stock Exchange?
- Examine the effect of corporate governance mechanisms on the inventory turnover ratio of the manufacturing listed in the Amman Stock Exchange?

### **Literature Review and Theoretical Framework**

Corporate governance, a phrase that a decade or two ago meant little to all but a handful of scholars and shareholders, has become a major concern of many academics, corporate directors and policy makers around the world. Several events make corporate governance an important issue to be discussed. The most important one is the financial crises in 1998 in Russia, Asia, and Brazil followed just a few years later by scandals in the United States and Europe that triggered some of the largest insolvencies in history. The confidence in the corporate sector was weakened and the need for corporate governance system becomes a necessary (Claessens and Yurtoglu, 2013).

The corporate governance after that becomes a household term. The researchers, the corporate world, and policymakers everywhere recognize the potential macroeconomic, distributional and long-term consequences of weak corporate governance systems (Claessens and Yurtoglu, 2013).

Corporate governance and its effect to the performance was and still huge area of debate in accounting theory, the main reason behind the study of these two variables is the agency problem, that refers to a conflict of interest between a company's management and the company's shareholders. The manager, who acting as

the agent for the shareholders, or principals, is supposed to make decisions that, will maximize shareholder wealth. However, it is in the manager's own best interest to maximize his own wealth. While it is not possible to eliminate the agency problem completely, the manager can be motivated to act in the shareholders' best interests through incentives such as performance-based compensation, direct influence by shareholders, or what is called 'corporate governance'.

The term "corporate governance" was identified to mean different things to different people (Kajola, 2008). According to Organization of Economic and Development (OCED) (1999) corporate governance was defined as the system by which business corporations are directed and controlled. Shleifer and Vishny (1997) defined corporate governance as the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. Taking a broad perspective on the issues, Gillan and Starks (1998) define corporate governance as the system of laws, rules, and factors that control operations at a company. Corporate governance is the relationship between corporate managers and the providers of equity, people and institutions who invest the capital to earn return (Abdur Rouf, 2011). Irrespective of the particular definition used, researchers often viewed corporate governance mechanisms as falling into one of two groups: those internal to firms and those external to firms.

According to the (OECD) principles, good corporate governance must provide appropriate incentives and rewards for the board of directors and the management to act in the interests of the company and the shareholders, to facilitate effective monitoring, and to encourage firms to use resources more efficiently. Good corporate governance focuses mainly in the protection of the rights of shareholders and play important role in the development of capital markets by protecting their interests.

Good corporate governance practices are essential in determining the cost of capital in capital markets (Abdur Rouf, 2011). Effective corporate governance systems provide confidence levels that are necessary for the proper performance of the market. Therefore, the cost of capital is lower and firms are encouraged to use resources more efficiently (OECD, 2004). Moreover, institutions try to become active by implementing the corporate governance policies of their firms. This activism based upon the belief that governance practices influence

subsequent firm performance.

Corporate governance covers mainly three dimensions, which are ownership structure, composition of board of directors, and Chief Executive Officer (CEO) (Al-Sharif, 2011). While reviewing the literature, it can be noticed that studies have mainly two approaches to measure the corporate governance. The first approach uses a composite measure of corporate governance, while the second approach focuses on single corporate governance attributes, such as ownership structure and board characteristics. Each approach will be discussed individually.

### **First Approach: Composite Measure of Corporate Governance**

Many researchers tried to investigate the effect of overall corporate governance on the operating performance. Gompers et al. (2003) have constructed a (G- index) to indicate the strength of shareholder rights of 1500 large firms during 1990s, the results indicated that firms with stronger shareholder rights had higher firm value, higher profits, higher sales growth, lower capital expenditures, and made fewer corporate acquisitions. The study stated that the correlation of the Governance Index with returns, firm value, and operating performance could be explained in several hypotheses: the first hypothesis stated that weak shareholder rights caused additional agency costs.

If the market underestimated these additional costs, then a firm's stock returns and operating performance would have been worse than expected, and the firm's value at the beginning of the period would have been too high. The second hypothesis stated that managers in the 1980s predicted poor performance in the 1990s, but investors did not. In this case, the managers could have put governance provisions in place to protect their jobs. While the provisions might have had real protective power, they would not have caused the poor performance. The third hypothesis stated that governance provisions did not cause poor performance (and did not need to have any protective power) but rather were correlated with other characteristics that were associated with abnormal returns in the 1990s. The study found some evidence in support of Hypothesis number one and no evidence in support of hypothesis number two.

For Hypothesis number three, the study found that manufacturing classification can explain somewhere between one-sixth and one-third of the benchmark

abnormal returns, but they didn't find any other observable characteristic that explains the remaining abnormal return. In addition, Bebchuk, et al. (2009) argued that some of these 24 provisions might matter more than others and that some of these provisions may be correlated. However, Core et al. (2006) results did not support findings by Gompers and others that the weak governance causes poor stock returns and suggest using operating performance when studying corporate governance and performance.

Moreover, Brown and Caylor (2006, 2009) examined fifty-one provisions covering eight dimensions of corporate governance and create a summary index from those provisions. They show that poorly governed firms have lower ROE, lower ROA and lower Tobin's Q.

Furthermore, Reddy, et al. (2010) tried to study the effect that principle-based corporate governance practices on the financial performance of large publicly-listed companies in 2004, after the New Zealand Securities Commission (NZSC) promulgated nine high level principles trying to improve corporate governance practices and boosting investor confidence in the New Zealand capital market. They used Panel data for the NZX top 50 companies over the period 1999-2007. They found that that the NZSC recommendations have had positive influence on firm's performance measured by Tobin's Q, MB and ROA.

### **Second Approach: Single Corporate Governance Measure**

Corporate governance characteristics were widely discussed in the accounting theory research, the researchers used many characteristics to indicate the corporate governance in the companies, some of these characteristics refer to the ownership structure while the other refer to the board of director, audit committee, disclosure and many others.

Whenever a research is conducted to study corporate governance, the legal structure and the origin of the law should be considered. In case of Jordan like many developing countries, the French civil law is applied (La Porta et al., 2000). Under this system the investor depends more on the internal mechanism, such as concentrated ownership, limited disclosure, and reliance on family finance and the banking system (La Porta et al., 1997; La Porta et al., 1998). Omran, et al. (2008), while studying ownership structure in Arab countries, including Jordanian market in their sample, mentioned that when the legal framework does not offer sufficient protection

for outside investors; entrepreneurs and original owners are forced to maintain large positions in their companies which result in a concentrated form of ownership.

### **Jordan's Corporate Governance Overview**

The legislative environment of corporate governance has been managed through many laws, such as the Company Law, Securities Law, Banking Law, Insurance Law, Commercial Law, Law of Competition and Monopoly, Law of Investment Promotion, and Law of Privatization (Al-Jazi, 2007).

Jordan securities commission had developed corporate governance code for shareholding companies listed in the Amman Stock Exchange based on the recommendations of (ROSC). The recommendation was done in June 2004 as part of the joint World Bank-IMF program of Reports on the Observance of Standards and Codes (ROSC) all over the world.

Chapter two of the corporate governance code stated important criteria's for the board of directors elections, period of serving, total number, qualifications and others such as:

1. The administration of the company is entrusted to a board of directors whose members shall be not less than five and not more than thirteen. Principles of good corporate governance require that board members be elected by the company's general assembly in a secret ballot, by means of cumulative voting system, provided that at least one third of the board members are independent members.
2. The board of directors represents all shareholders. It should exercise due professional care in managing the company, and devote the time needed to carry out its activities in honesty and transparency in order to serve the company's interests and realize its objectives.
3. It is not allowed for one person to hold the positions of chairman of the board of directors and any executive position in the company at the same time.
4. Member of the board of directors should be qualified and enjoys adequate knowledge and experience in administrative affairs. He should also be aware of relevant legislation and of the rights and duties of the board.
5. The company is not allowed to provide a cash loan of any kind to the chairman or any member of the board of directors or to any of their relatives. Excluded from this condition are banks and financial companies that

may advance loans to any of the aforesaid persons within the limits of these companies' objectives and in accordance with the same conditions that apply to all customers.

6. The company shall provide members of the board of directors with all information and data related to the company, to enable them to perform their duties and to be aware of all aspects related to the company's work.
7. The board of directors shall ensure that members of the executive management have the administrative and technical qualifications and experience that they need to carry out their duties.

It can be noticed that the code has a great interest of the board of directors members, the code has specify the total number, the qualifications, and equal and justice treatment for the shareholders. The most important thing that has been emphasized above is the independency of the board members as the CEO cannot be the chairman and the members of the board are not allowed to take a loan from the companies to maintain their independence. These high and specific requirements come from the fact that the board members are expected to play an important role in the corporate government environment in the companies.

Companies' law has organized the board of directors for shareholding companies. The Companies Law No. 22 of 1997 article (132) states that the management of a Public Shareholding Company is entrusted to a Board of Directors whose members shall not be less than three and not more than thirteen as determined by the Company Memorandum of Association. Also, the members of the Board shall be elected by the Company General Assembly by means of a secret ballot in accordance with the provisions of this Law. The Board of Directors shall undertake the management of the Company for four years as from the date of its election.

Article (133 states that:

1. The Public Shareholding Company Memorandum of Association shall specify the number of shares which must be held by a member to qualify for nomination as a member of the Board of Directors, and to retain his position as a member therein.

2. The qualifying number of shares for membership on the Board of Directors shall continue to be attached as long as the owner of such shares is a member of the Board of Directors and for a further period of six months following the expiry date of his term

therein. Such shares may not be negotiated during that period.

Article (137) states the that Board of Directors of the Public Shareholding Company shall elect from amongst its members by means of a secret ballot a chairman and a deputy chairman to assume the duties and responsibilities of the chairman during his absence.

Article (153): The General Manager's Duties and Powers

1. The Board of Directors shall appoint a qualified person to act as general manager of the Public Shareholding Company and shall specify his powers and responsibilities in accordance with instructions issued by the Board for this purpose. The Board shall authorize the said manager to carry out the management of the Company in cooperation with the Board of Directors and under its supervision.
2. The Board shall determine the salary of the general manager, provided he is not a general manager of more than one Public Shareholding Company.
3. The Board of Directors of the Public Shareholding Company shall have the right to terminate the services of the general manager provided that the Controller is informed of any decision taken thereby regarding the appointment of the Company general manager or the termination of his services as soon as the decision is taken.
4. If the Company securities are listed in the Market, then the Market shall be notified of any decision taken as to the appointment of the Company general manager or the termination of his services as soon as the decision is taken.
5. The chairman of the Board of Directors of a Public Shareholding Company or any of its members are not entitled to assume any duty or employment in the Company for a salary, compensation or remuneration, except for those provided for in this Law in situations where the nature of the work of the Company requires same and which have been approved by a two-thirds majority vote of the Board of Directors' members, provided that the concerned person shall not participate in the voting.

Securities and Exchange Commission has mentioned the ownership structure in the content of its law. Item No. 45 of the Jordan Securities Commission law for year 2002 prohibits individuals and firms from owning more than 40% of the shares issued by any financial or non financial firm unless they were acquired through an

“ownership offer” approved by the securities commission. Finally, Jordanian commercial laws prohibit foreign investors from owning more than 50% of the capital of firms that operate in certain types of the transportation manufacturing, owning more than 49% of firms that operate in air transportation and aircraft rental industries, and owning any shares in firms operating in particular transportation, security, and sports industries. (Bino et al., 2010)

We can notice from the above legislation the following:

1. Amman stock exchange within its corporate governance code was more conservative than the companies laws as the minimum number of the board of directors members was five instead of three on the companies law.

2. There is no item in the company’s law that prohibits the duality between CEO and general manager in contrast with the code.

3. The code and the law is consistent with the fact that the board of directors responsibilities to oversee and monitor the shareholding companies’ management.

#### **What Distinguishes this Study From Other Studies?**

This research tries to use five corporate governance mechanisms to represent corporate governance and ownership structure and link them with accounting measure to see if the corporate governance could affect the company’s performance.

This study is different from others not only in timing but also in the number of measurement areas that were tested. Many prior studies focused on one or two performance dimensions. Relying on a small number of measures to investigate performance increases the potential for discovery oversight. This study used four accounting measure to indicate performance and five corporate governance characteristics.

Most prior research in Jordan tried to study the corporate governance using questionnaires or content analysis, little research in Jordan which tried to link the governance with performance based on archival data and with the light to manufacturing and service sectors.

#### **Data and Methodology**

This section discusses the variables included in the study and the statistical techniques applied in investigating the relationship between corporate governance mechanisms and accounting performance.

#### **Research Hypotheses**

In order to study the relationship between corporate governance mechanisms and operating performance, the following hypotheses need to be tested:

**The first main hypothesis:** The corporate governance mechanisms do not affect the return on assets of the manufacturing firms listed in the Amman stock exchange.

#### **Sub-hypotheses:**

**H1-1:** The percentage of state ownership does not affect the return on assets of the manufacturing firms listed in the Amman stock exchange.

**H1-2:** The percentage of foreign investor’s ownership does not affect the return on assets of the manufacturing firms listed in the Amman stock exchange.

**H1-3:** The percentage of the shares owned by the largest shareholder does not affect the return on assets of the manufacturing firms listed in the Amman stock exchange.

**H1-4:** Whether the roles of CEO and chairman are separated does not affect the return on assets of the manufacturing firms listed in the Amman stock exchange.

**H1-5:** The total number of the board of directors’ members does not affect the return on assets of the manufacturing firms listed in the Amman stock exchange.

**The Second main hypothesis:** The corporate governance mechanisms do not affect the return on equity of the manufacturing firms listed in the Amman stock exchange.

#### **Sub-hypotheses:**

**H1-1:** The percentage of state ownership does not affect the return on equity of the manufacturing firms listed in the Amman stock exchange.

**H1-2:** The percentage of foreign investor’s ownership does not affect the return on equity of the manufacturing firms listed in the Amman stock exchange.

**H1-3:** The percentage of the shares owned by the largest shareholder does not affect the return on equity of the manufacturing firms listed in the Amman stock exchange.

**H1-4:** Whether the roles of CEO and chairman are separated does not affect the return on equity of the manufacturing firms listed in the Amman stock exchange.

**H1-5:** The total number of the board of directors’ members does not affect the return on equity of the manufacturing firms listed in the Amman stock exchange.

**The Third main hypothesis:** The corporate

governance mechanisms do not affect the total assets turnover ratio of the manufacturing listed in the Amman stock exchange.

**Sub-hypotheses:**

**H1-1:** The percentage of state ownership does not affect total assets turnover ratio of the manufacturing firms listed in the Amman stock exchange.

**H1-2:** The percentage of foreign investor's ownership does not affect total assets turnover ratio of the manufacturing firms listed in the Amman stock exchange.

**H1-3:** The percentage of the shares owned by the largest shareholder does not affect total assets turnover ratio of the manufacturing firms listed in the Amman stock exchange.

**H1-4:** Whether the roles of CEO and chairman are separated does not affect total assets turnover ratio of the manufacturing firms listed in the Amman stock exchange.

**H1-5:** The total number of the board of directors' members does not affect total assets turnover ratio of the manufacturing firms listed in the Amman stock exchange.

**The Fourth main hypothesis:** The corporate governance mechanisms do not affect the inventory turnover ratio of the manufacturing firms listed in the Amman stock exchange.

**Sub-hypotheses:**

**H1-1:** The percentage of state ownership does not affect the inventory turnover ratio of the manufacturing firms listed in the Amman stock exchange.

**H1-2:** The percentage of foreign investor's ownership does not affect the inventory turnover ratio of the manufacturing firms listed in the Amman stock exchange.

**H1-3:** The percentage of the shares owned by the largest shareholder does not affect the inventory turnover ratio of the manufacturing firms listed in the Amman stock exchange.

**H1-4:** Whether the roles of CEO and chairman are separated does not affect the inventory turnover ratio of the manufacturing firms listed in the Amman stock exchange.

**H1-5:** The total number of the board of directors' members does not affect the inventory turnover ratio of the manufacturing firms listed in the Amman stock exchange.

The corporate governance will be measured by the following measures:

- 1- Percentage of State ownership.
- 2- Percentage of foreign investor's ownership.

3- Percentage of the shares owned by the largest shareholder.

4- Whether the roles of CEO and chairman are separated.

5- The total number of the board of directors' members.

**The Model of the Study**

This study use the multiple regression analysis to investigate the effect of the independent variable (corporate governance) on the dependent variable (Operating Performance), and the test will be done through the following model:

$$PERF = \alpha_0 + \alpha_1 STATE + \alpha_2 FOREGIN + \alpha_3 LARGEST + \alpha_4 DUAL + \alpha_5 TOTAL\ NUMBER + \alpha_6 LASSETS + \alpha_7 LEVERAGE + e_{it}$$

PERF = a measure of performance. Performance will be measured by the following measures: ROA, ROE, TATO, inventory turnover.

Whereas: ROA: is return on Asset, ROE: is return on Equity, TAT: is asset turnover ratio IT: is inventory turnover ratio, STATE: Percentage of State ownership, FOREIGN: Percentage of foreign investor's ownership, LARGEST: Percentage of the shares owned by the largest shareholder, DUAL: whether the roles of CEO and chairman are separated, INDEPENDENT: Independent outside directors as the proportion of total number of board members, NUMBER: The total number of the board of directors' members, LEVERAGE: total debt divided by total assets, LASSATES: The log of total assets.

This regression will be run four times with each performance variable.

**Data Collection**

Data included in this study was obtained directly from Amman stock exchange site ([www.ase.com.jo](http://www.ase.com.jo)). The site contains the companies guide, this guide consist the full balance sheets, income statements, the names and immediate holdings of all owners that hold more than 5% of a company's stock; it also provides the identity of CEO and members of board of directors and the total number of the members of the board.

Data regarding performance was taken from the web site and calculated by the researchers. Data regarding corporate governance mechanisms was taken from a PDF file available in companies guide. This PDF file contains the names of the largest shareholders, the percentage of

foreigner ownership, state ownership, the name of CEO and chairman, the total number of the board member.

### Population and Sample

The population of this study consists of manufacturing companies listed in the Amman stock exchange during the period 2005-2009. The sample consists of all manufacturing companies that have available data related to corporate governance and performance. The total number of companies was 94 manufacturing companies. However, the data for 69 manufacturing companies was used in the study. The remaining (25) companies were excluded from the sample because either the corporate governance data were not available for 4 years at least or the data for the four performance measures that were used in the study were not available for 4 years at least.

### Study Period

The study covers the period from 2005 to 2009, various data required for year 2004 to compute study variables. The reason for restricting the study to this period was that the latest data for investigation is available for this period; corporate governance mechanisms data is not available after that. The Amman Stock Exchange has stopped issuing the PDF file that contains corporate governance mechanisms data after 2009 and that was the main reason behind stopping at this point of time.

### Variables Definitions

#### The Independent Variable: (Corporate Governance)

It is argued that in less developed countries firms are controlled by multiple large shareholders, and they also participate in management (Claessens, et al., 2000; la Porta et al., 1999; Omran, et al., 2008). With that in mind, the first four variables will be used in this study:

- LARGEST: Percentage of shares that owned by investors who owned more than 5%.
- STATE: Percentage of shares that owned by State.
- FOREIGN: Percentage of shares that owned by foreign investors.
- DUAL: whether the roles of CEO and chairman are separated. Dual is a dummy variable that coded 0 if the chairman is also the CEO and 1 otherwise.
- NUMBER: The total number of the board of directors' members. Board of directors considered as an

integral part of the corporate governance in firms.

The total number of board of directors has been extensively studied in the literature however the results in emerging markets are still mixed.

#### The Dependent Variable: (Operating Performance)

This study used Return on Assets (ROA) and Return on Equity (ROE) to measure firm performance. These measures of firm performance have been used extensively in corporate governance research (e.g. Laffont and Triole, 1991; Xu and Wang, 1997; Heracleous, 2001; Omran, et al. 2008; Zeitun 2007; Sami, et al. 2011.).

The ROA is an accounting measure of firm's performance. It is a measure of current profitability, and arguably, the simplest and most intuitive measure of firm's performance (Kumar, 2003). The ROA ratio measure how profitable and efficient the company's management is in utilizing and allocating its assets to generate net income. ROA measures how much profits a firm can achieve using one unit of assets. It helps to evaluate the result of managerial decisions on the use of assets which have been entrusted to them.

ROE measures the earnings generated by shareholders' equity of a period of time, usually one year.

Creditors usually receive a fixed return on their financing; yet common shareholders are provided no fixed or promised returns. ROE represent the claims for the shareholders on the residual earnings of a company only after all the financing sources are paid. It encompasses three main levers which management can utilize to ensure health of the firm: profitability; asset management; and financial leverage.

In addition, this study will use additional sub measures to indicate performance the total assets turnover ratio and inventory turnover ratio was used in this research. The total assets turnover ratio measures the ability of a company to use its assets to efficiently generate sales. While the total assets turnover ratio considers all assets, the inventory turnover ratio measures the efficiency of the business in managing and selling its inventory. This ratio gauges the liquidity of the firm's inventory. This ratio shows how many times a company's inventory is sold and replaced over a period; low turnover is usually a bad sign because products tend to deteriorate as they sit in a warehouse.

These four performance ratios were calculated as follow:

- Return on assets (ROA): calculated by dividing net

income plus interest expense on the average assets. The main reason for adding the interest expense net of tax to the numerator is the attempt to neutralize the effect of interest expense to compare between companies for its operation irrespective to leverage.

- Return on equity (ROE): calculated by dividing net income pertains to shareholder on the average shareholders' equity.
- Asset Turnover (TAT): Calculated by dividing sales on the average assets.
- Inventory Turnover (IT): Calculated by dividing cost of goods sold on the average inventory.

**The Control Variables**

Heraclueous (2001) emphasized that the researchers must develop methodologies that can account for multiple, systematic influence of the firm's performance and avoid the models that tries only to correlate only one element and firm's performance.

Thus and in order to control for other possible determinates of firm's profitability not captured by the ownership and board variables, this research included two control variables into regression analysis to control for firms characteristics.

The control variables used in this study are leverage and log of total assets. These variables have been selected with references to (e.g. .Omran, et al., 2008; Zeitun, 2007; Sami et al., 2011).

- LEVERAGE: Calculated as total debt divided by total assets. leverage represents the proportion of financing obtained via debt. A firm's debt to assets reflects the corporation ability to borrow and the cost of borrowing.

- LASSATES: The natural logarithm of book value of total assets. It would not be appropriate to include total assets and its absolute number as a proxy of companies' size, rather the logarithm of the total assets (LASSATES) must be included. That is necessary to obtain more meaningful coefficients for companies' performance in the regression analysis since most independent variables are entered as ratios.

**Empirical Studies**

In this section, the results of the data analysis are presented and discussed. The analysis takes place through four stages: the first stage, descriptive analysis is used to describe the features of the variables of the study by calculating means, standard deviation, minimum and maximum for the variables of the study.

In the second stage the nature and direction of the relationship between the corporate governance mechanisms and firm performance are examined using Pearson correlation. The third stage will be the testing for multicollenairaty problem between independent variable. The fourth and the final stage is the regression analysis.

The regression analysis is used to examine the effect of corporate governance mechanisms on firm's performance, as corporate governance mechanisms and firm performance are the independent and the dependent variables. To be mentioned that the outliers has been removed to reduce the effect of extreme values of the four performance measures at the 1st and 99th percentile.

**Descriptive Statistics**

Descriptive statistics are used to calculate minimum, maximum, standard deviation and means.

	Minimum	Maximum	Mean	Std. Deviation
ROA	-0.324	0.508	0.031	0.091
ROE	-1.442	0.753	0.010	0.192
TAT	0.000	2.955	0.634	0.437
IT	0.000	89.667	4.577	9.049
LEVERAGE	0.000	1.003	0.322	0.217
LASSETS	13.756	20.602	16.568	1.257
FOREIGN	0.000	1.000	0.168	0.222
STATE	0.000	0.913	0.077	0.145
LARGEST	0.000	0.985	0.536	0.235
DUAL	0.000	1.000	0.870	0.335
TOTAL NUMBER	3.000	13.000	8.020	2.141

ROA: Return on assets, ROE: Return on equity, TAT: total assets turnover ratio, IT: Inventory turnover ratio, LEVERAGE: Debt ratio, LASSETS: log of total assets, FOREIGNN: Percentage of shares owned by foreigners, STATE: Percentage of shares owned by governmental sector, LARGEST: The percentage of shares owned by largest shareholders, DUAL: Whether the roles of the CEO and chairman are separated, TOTAL NUMBER: Total number of the board of director members.

As it appears in table (1) the first four variables measures the performance, the mean of the return on assets is 3.1% while the mean of the return on equity was 1%. The mean of both performance measures indicate a low performance of manufacturing companies indicates of a poor performance. Omran et al, (2008) mentioned in his research that Jordanian companies are least profitable in a sample of four Arab firms. The total assets turnover ratio's mean was .634 times which means that the manufacturing company can generate around .634 times sales from its average assets which indicate low efficiency in the company's usage of its recourses. The last performance measure was inventory turnover ratio with a mean of 4.577. The fifth and sixth variables are the controlling variables of the model, the log of total assets and the debt ratio that shows that manufacturing companies are leveraged with an average of 32.2%. And finally the last five variables measure the corporate governance mechanisms. The mean of the percentage shares owned by the foreigners was 16.8% which indicate significant percentage to be studied. The largest shareholders owned on average 53.6% of the shares of the company, the maximum observation is 98.5% while the minimum observation is .8%. The separation between

the CEO and chairman is a dummy variable that took the value of 0 if there is no separation and the value of 1 if there is a separation; the mean of this variable is 87% which indicate that 13% has no separation between the CEO and chairman which violates the second item in chapter two in the corporate governance code for shareholding companies issued by Amman stock exchange, and the last variable is the total number of the board of directors members, the average number of the members is around 8, the minimum is 3 and the maximum is 13 and this is consistent with companies law where the provisions of article (132) no. (22) Of 1997, indicate that the number of Board members should be at least three members and no more than thirteen. It can be seen from the table that the variable with the highest standard deviation is the inventory turnover ratio which indicates a high volatility in this item.

### Correlation Analyses

In order to examine the relationship between dependent and independent variables a bivariate correlation between the four performance measures and corporate governance measures is used.

		Foreign	State	Largest	Separation	Total
<b>ROA</b>	Pearson Correlation	-.051	.016	-.003	.032	.192
	Sig. (2-tailed)	.372	.777	.954	.575	.001**
		Foreign	State	Largest	Separation	Total
<b>ROE</b>	Pearson Correlation	.015	-.059	-.115	.033	.137
	Sig. (2-tailed)	.798	.304	.042*	.561	.016*
		Foreign	State	Largest	Separation	Total
<b>TAT</b>	Pearson Correlation	.019	-.109	-.087	.010	-.104
	Sig. (2-tailed)	.737	.058	.126	.861	.068
<b>IT</b>	Pearson Correlation	.071	.111	-.030	.137	.042
	Sig. (2-tailed)	.224	.057	.610	.019*	.470
*, ** significant at the 0.05 and 0.01 levels, respectively.						

Table (2) shows the correlation matrix between the dependent and independent variables. The total number of board of director members has a significant positive correlation with ROA and ROE; this means the higher the

number of board members the higher the ROA and ROE. It can be noticed that the separation between chairman and CEO and the total number of board of directors have a significant positive correlation with the inventory

turnover ratio. Since the correlation may present a coincidental effect between dependent and Independent variables, and it does not present a relationship between them, using an OLS Regression that depend on linking the co-variances -comparing the volatilities- of the firm’s corporate governance with its performance give us the real existence of the proposed relationship between variables and the degree of significance of this relationship.

**The Multicollinearity Between Independent Variables**

In this section the correlation matrices between independent variables and variance inflation factors test are presented to examine whether the multicollinearity

exist between independent variables. Although correlation matrices might indicate the multicollinearity problem, correlation matrices only work with two variables at a time. This pair wise relationship can only be seen. If a more complicated relationship exists, the correlation matrix won’t find it. In the case of multicollinearity, the P- values are ignored; the main concern for indicating this problem is the value of R. if the value of R is highest than .8 the collinearity problem might exist (Berenson et al., 2012).

Table (3) presents the correlation matrices between the independent variables in manufacturing sector.

**Table 3. Correlations between independent variables for manufacturing sector companies**

		Foreign	State	Largest	Separation	Total
Foreign	Pearson Correlation	1				
	Sig. (2-tailed)					
State	Pearson Correlation	.039	1			
	Sig. (2-tailed)	.493				
Largest	Pearson Correlation	.377	.267	1		
	Sig. (2-tailed)	.000**	.000**			
Separation	Pearson Correlation	.103	.104	.203	1	
	Sig. (2-tailed)	.076	.071	.000**		
Total Number	Pearson Correlation	-.202	.318	-.280	-.058	1
	Sig. (2-tailed)	.000**	.000**	.000**	.315	

Variance inflation factors measure the relationship of all the variables simultaneously, thus they avoid the “two at a time” disadvantage of correlation matrix.

The collinearity might be a problem to be concern when the VIF exceeds 10. Other statisticians suggest a

more conservative criterion recommends solving this problem when VIF exceeds 5(Berenson et al., 2012). In the tables (4) the VIF is near to 1 and does not exceed two which indicates the collinearity problem is not a problem in this research’s regression model.

**Table 4. Variance inflation factors for the manufacturing sector companies.**

	Manufacturing							
	ROA		ROE		TAT		IT	
	Collinearity Statistics		Collinearity Statistics		Collinearity Statistics		Collinearity Statistics	
	Tolerance	VIF	Tolerance	VIF	Tolerance	VIF	Tolerance	VIF
(Constant)								
Debt	.901	1.110	.902	1.109	.901	1.109	.848	1.179
Log OF ASSETS	.718	1.393	.716	1.397	.718	1.393	.665	1.503
Foreign	.770	1.298	.747	1.339	.769	1.301	.700	1.429
State	.708	1.413	.722	1.385	.708	1.413	.716	1.397
Largest	.621	1.610	.661	1.512	.621	1.610	.643	1.555
Separation	.934	1.071	.935	1.070	.936	1.068	.939	1.065
Total	.642	1.559	.666	1.501	.642	1.559	.657	1.521

**OLS Regression Analyses**

In order to study the effect of the corporate governance mechanisms on firms' performance, OLS regression estimates are presented and discussed. To estimate the relationships between firms' performance

and corporate governance, the null hypotheses of the study are supposed to be tested by the following model:

PERF = a measure of performance (ROA, ROE, TATO, inventory turnover).

<b>Table 5. OLS Regression Results: The dependent variable is return on assets.</b>			
R square	0.22		
Adjusted R square	0.201		
F- value	11.504		
Significance of F	0.000**		
<b>The independent variables</b>	<b>Beta</b>	<b>T</b>	<b>Sig.</b>
Constant		-7.762	0.000**
Leverage	-.165	-3.406	0.001**
Lassets	.469	7.658	0.000**
Foreign	-.174	-2.901	0.004**
State	-.148	-2.373	0.018*
Largest	.141	2.11	0.036*
Dual	.054	1.001	0.317
Total	.082	1.245	0.214

\*, \*\* significant at the 0.05 and 0.01 levels, respectively.

Table (5) shows the results of regression analysis between return on assets and corporate governance controlled by firm size and leverage.

When looking on the coefficients of each measure of the corporate governance, it can be noticed that the percentage of shares owned by state has a negative effect on the ROA and it is statistically significant at 5% level of significance so that the null hypothesis rejected and the alternative one is accepted. This negative sign can be explained as the main concern for government is the social benefits and not the accounting profit. This results is consistent with Zeitoun and Tian (2007) and Gunasekarage et al., (2007). The second thing to be mentioned here is that the percentage of shares owned by foreigners has negative coefficient in ROA equation and it is statistically significant at 1% level and therefore, the null hypothesis is rejected. The largest shareholders have positive impact on ROA at 5% level of significance. This positive relationship is in support of the Shleifer and

Vishny (1986) hypothesis that large shareholders may reduce the problem of small investors and therefore improve its performance. These results are also consistent with Wu and Cui (2002) that there is positive relationship between relationship and accounting profits. Our results are also consistent with Abdel Shahid (2003).

Both controlling variables are significant in ROA equation, the log of total assets as indicator to the size of the firm has positive impact on the firm's performance; larger companies tend to perform better than small companies. Leverage indicated by total debt to total assets have negative significant impact on the company's performance; more borrowing by companies indicate more cost of capital and therefore low performance. Although the separation between the CEO and chairman and total number of board of directors have positive coefficients in the equation above but none of these coefficients is significant at any level.

<b>Table 6. OLS Regression Results: The dependent variable is return on equity</b>	
R square	0.079
Adjusted R square	0.056
F- value	3.525

Significance of F	0.001**		
The independent variables	Beta	T	Sig.
Constant		-1.617	0.107
Leverage	-.246	-3.185	0.002**
Lassets	.133	1.578	0.116
Foreign	.040	0.676	0.499
State	-.089	-1.106	0.27
Largest	-.072	-1.129	0.26
Dual	.031	0.619	0.536
Total	.099	1.478	0.141

\*, \*\* significant at the 0.05 and 0.01 levels, respectively.

Table (6) shows the results of regression analysis between return on equity and corporate governance mechanism controlled by firm size and leverage. The

results indicate that the only variable that significantly explains the variation in ROE is the leverage as controlling variable.

**Table 7. OLS Regression Results: The dependent variable is Total Assets Turnover Ratio**

R square	0.052		
Adjusted R square	0.029		
F- value	2.257		
Significance of F	0.030**		
The independent variables	Beta	T	Sig.
Constant		0.514	0.608
Leverage	.026	-0.108	0.914
Lassets	.147	2.361	0.019*
Foreign	.022	0.324	0.746
State	-.059	-0.955	0.34
Largest	-.145	-1.958	0.051
Dual	.061	0.993	0.321
Total	-.184	-2.58	0.010**

\*, \*\* significant at the 0.05 and 0.01 levels, respectively.

Table (7) shows that the total number of board of directors has a negative impact on the total assets turnover ratio at the .01 level of significant, and the log of assets

significantly affect the turnover ratio at .05 level of significance.

**Table 8. OLS Regression Results: The dependent variable is Inventory Turnover Ratio**

R square	0.079		
Adjusted R square	0.055		
F- value	3.366		
Significance of F	0.030*		
The independent variables	Beta	T	Sig.
Constant		-2.038	0.043*
Leverage	-.069	-1.127	0.261

Lassets	.218	3.092	0.002**
Foreign	.022	0.339	0.735
State	.105	1.566	0.119
Largest	-.112	-1.58	0.115
Dual	.162	2.717	0.007**
Total	-.103	-1.428	0.154
*, ** significant at the 0.05 and 0.01 levels, respectively.			

Table (8) shows that the separation between CEO and chairman and the log of assets have positive significant effect on the IT.

### Discussion of Results

The previous section analyses investigate the cause effect relationship between corporate governance mechanisms and performance measured by ROE, ROE, TAT and IT.

The study finds an evidence of the existence of the relationship between the performance measured by ROA, ROE, TAT and corporate governance mechanisms. These findings are consistent with Sami et al., (2011). The significant impact of the percentage shares owned by the largest shareholder in ROA and IT in the manufacturing companies is in support of the Shleifer and Vishny (1986) hypothesis that large shareholders may reduce the problem of small investors and therefore improve its performance.

However the results show inconsistent sign of that state ownership coefficient. While it seems to have significant negative relationship with the performance indicated by ROA and IT, it has a positive effect on TAT and no effect in ROE. The negative sign in ROA and IT models is expected as the main concern of government is social benefit rather than profit. Our results are consistent with Zeitoun and Tian (2007) and Gunasekarage et al., (2007).

In ROA and ROE regression, both controlling variables firms' size and leverage have significant impact on the firm's performance. In general, the sign of the coefficients for those control variables are consistent with previous findings.

The significance of corporate governance measure in the equations of ROA and ROE and higher explanation power could be explained by the fact that the ROA and ROE are the most important factors used by the investors in Jordan to asses a firm's performance rather than other measures Zeitoun and Tian (2007).

And the last thing to be mentioned here is that the descriptive statistics and regression results for cross sectional data are available in the appendix (2).

### Conclusion and Recommendations

Several studies have been conducted on the examination of the relationship between firm performance measures and corporate governance mechanisms, but the outcomes of these studies are mixed.

This study examines the relationship between firm performance, using four proxies (ROA, ROE, TAT and IT) and five corporate governance mechanisms (largest shareholders, foreign ownership, separation between CEO and chairman and board size). A sample of 69 manufacturing Jordanian firms listed in the Amman stock exchange for a period of five years from 2005-2009 are examined. Panel data methodology is employed; the method of analysis is multiple regressions and the method of estimation is OLS.

- The study reveals the following results:
- The largest shareholders have significant positive effect on ROA.
- The total number of the board of directors has significant positive effect TAT.
- The percentage of shares owned by state seems to have negative significant effect on ROA.
- The separation between the CEO and chairman has a significant positive effect on the IT.
- The percentage of shares owned by the foreigners has a negative impact on ROA.
- Unfortunately, at the beginning of this study we were challenged by a group of limitations that are:
- The corporate governance mechanisms data are not available after 2009.
- The lack of corporate governance information and other related information for some firms listed on ASE for the years of the study.
- Our analysis focused on the formal factors of the firms and ignored the other informal factors that may

affect relations between the family corporate governance and performance such as social and psychological factors.

- These findings allow for some interesting interpretation and provide important implications for the governance reform process. These findings provide empirical evidence to support new requirements by policy makers to set policies that improve the governance in Jordan.
- In light of the results of this study, we can provide the following recommendations:
- The regulatory bodies should aware of duality between the CEO and Chairman which is inconsistent with corporate governance code for shareholding companies issued by Amman stock exchange that seems to have a negative effect on performance.
- This study focuses on some mechanisms of corporate

governance, further analysis is recommended to study the effect of other mechanisms (such as institutional ownership, audit committee, Whether there is relationship among the top 10 shareholders and Independent outside directors as the proportion of total number of board members).

- Efforts should be made to make the corporate governance principles mandatory by Amman stock exchange as soon as possible.
- Amman stock exchange should keep issuing the PDF file that contains important data regarding corporate governance so that the scholars and researchers can keep studying the relationship between corporate governance and several important things such as performance, disclosure, cash flow and the liquidity of the stock.

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## أثر الحاكمية المؤسسية على الأداء للشركات الصناعية الأردنية: دليل من سوق عمان المالي

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### ملخص

يهدف هذه البحث الى فحص العلاقة بين اليات الحاكمية المؤسسية واداء الشركات الصناعية المدرجة في بورصة عمان، وذلك باستخدام مقياس العائد على الأصول، والعائد على حقوق الملكية، ومعدل دوران الاصول، ومعدل دوران المخزون كمقاييس للاداء. تكون مجتمع الدراسة من الشركات الصناعية المدرجة في بورصة عمان، وتضمنت عينة الدراسة جميع الشركات التي توفرت عنها بيانات الدراسة والتي بلغت (69) شركة للفترة ما بين 2005-2009. واستخدمت الدراسة طريقة الانحدار المتعدد لاختبار فرضيات الدراسة.

تم من خلال هذه الدراسة اختبار أثر كل من نسبة الأسهم المملوكة من قبل كبار المساهمين ونسبة ملكية الأجانب نسبة ملكية الدولة والفصل بين رئيس مجلس الادارة والمدير التنفيذي وعدد أعضاء مجلس الادارة على أداء الشركة المالي. أظهرت النتائج ان العائد على الأصول والعائد على حقوق الملكية ومعدل دوران الأصول تتأثر باليات الحاكمية المؤسسية. توصي هذه الدراسة باجراء المزيد من الأبحاث لدراسة اليات أخرى للحاكمية المؤسسية ، كما يجب على الجهات المعنية التنبيه الى عدم فصل الشركات بين مناصبي رئيس مجلس الإدارة والمدير العام، وأخيرا فأن مبادئ الحاكمية المؤسسية يجب أن تصبح اجبارية لما لها من أهمية.

**الكلمات الدالة:** الحاكمية المؤسسية، الاداء المالي، سوق عمان المالي.

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