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BOARD OF DIRECTORS CHARACTERISTICS AND FIRMS PERFORMANCE AMONG JORDANIAN FIRMS, PROPOSING CONCEPTUAL FRAMEWORK

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Abstract— This paper proposes a conceptual framework to investigate the relationship between board of directors' characteristics (Board of directors' independence, board of directors' size, family members at board of directors, board of directors meetings, CEO duality, and existence of nominations and compensation committee) and firms' performance among industrial companies listed on Amman Stock Exchange. Previous studies focused on the importance of board of directors as a main component of corporate governance rules and pointed out that the main role of board of directors is monitoring the firm's operations with the aim of developing and improving the firms' performance. In Jordan, in light of the development of the Jordanian national economy at all levels, and in light of the government's efforts to attract foreign and domestic investments and to stimulate companies to perform better, this study argues that the firms with effective of board of directors characteristics are able to enhance and increase the firms' performance.

Key words— Board of directors, corporate governance, Firm performance, Jordan.

I. INTRODUCTION

Applying corporate governance rules has become important for public and private sectors, and a tool for enhancing confidence in any national economy and an evidence of the existence of fair and transparent polices for protecting investors and traders alike. It is also an indication to the level of professional commitments reached by the firm's managements towards good governance, transparency and accountability, the existence of measures to limit corruption, and consequently raise the economy's attractiveness to local and foreign investments and bolstering its competitiveness [1].

Corporate governance enhances the firms' performance and protects the shareholders interests. Also, good corporate governance helps the firms to manage its resource by attracting new investors and capital funds. Another important benefit of corporate governance is an effective tool to help the firm to achieve better performance [2].

Along with the importance of corporate governance , there is a growing interest to study the effect of corporate governance rules on firm performance, is that poor performance, due to confiscated of minority shareholders and misuse of the firms' resources, has a significant result to business and the economy [3]. Also, poor performance leads to loss of reputation and to shakes the confidence of shareholders and investors in shareholding firms [3].

Boards of directors as a rule of corporate governance become important for smooth functioning of firms and improve the performance. Boards are expected to perform different functions, for example, monitoring of management to mitigate agency costs, hiring and firing of management, provide and give access to resources, grooming CEO and providing strategic direction for the firm to enhance the performance [4]; [5]; [6].

Boards also have a responsibility to initiate organizational change and facilitate processes that support the organizational mission. Further, the boards seek to protect the shareholder's interest in an increasingly competitive environment while maintaining managerial professionalism and accountability in pursuit of good firm performance [7].

This study aimed to investigate in the importance of the board of directors' characteristics and firm performance. So, this study chosen the financial performance indicators based on some points; first, it is commonly widely used, and it is useful and meaningful. Second, it is free of bias, because it is depend on real figures extracted from audited financial statements. Third, it is used as a tool for identifying irregularities in management behavior and firm's opportunities [8].

This paper proposes a conceptual framework to investigate the relationship between board of directors' characteristics (Board of directors' independence, board of directors' size, family members at board of directors, Board of directors meetings, CEO Dual, and Nominations and compensation committee) and firms' performance among industrial companies listed on Amman Stock Exchange. The remainder of the paper is organized as follows: Introduces the background of the study in section 2. Literatures review in section 3, the conceptual framework and hypothesis development presented in section 4. Summaries and concludes this paper in section 5.

II. BACKGROUND

In light of the development of the Jordanian national economy at all levels, and consistent with the Jordan Securities Commission's efforts to develop the national capital market, the Jordanian corporate governance code was issued in 2009.

The Jordanian corporate governance code contains rules of corporate governance for shareholding companies listed at Amman Stock Exchange (ASE) for the purpose of creating a framework that regulates their relations and management and defines their rights, duties and responsibilities in order to realize their objectives and safeguard the rights of all stakeholders. These rules are based principally on a number of legislations, mainly the Securities Law and related regulations, the Companies Law, and the international principles established by the Organization of Economic Cooperation and Development (OECD) 2008 [1].

The Jordanian corporate governance code stated, to enhance the firms performance that the board of directors should include a balance of executive directors and non- executive directors in

order to ensure that the board's decision making is not dominated by a certain party [1]. The best practices of the code also recommend that the responsibilities of the chairman and the chief operating officer should not be held by the same person to ensure that there is a balance of power and authority [1]. The appointments to the board should be made by a nomination committee and the directors should undergo an orientation and education programs [1].

III. LITERATURE REVIEW

The board of directors is the top executive unit of a company and be responsible for supervising of the company's management. And it is legally and ethically responsible for the shareholders.

Limited numbers of previous studies have examined the relationship between the firm performance and board of directors' characteristics. These studies argued that the board of directors as a significant part of corporate governance code is responsible for the decline in shareholders' wealth, corporate failure and the decline in the performance of firms. This due to the lack of vigilant oversight functions by the board of directors, the board relinquishing control to corporate managers who pursue their own self-interests [9]. So, various corporate governance reforms have specifically emphasized on appropriate changes to be made to the board of directors in terms of its composition, structure and ownership configuration to arrive to better performance [9].

There is believed that corporate governance enhances the firm performance and protects shareholders' interests. The effective economic roles of practicing good corporate governance are to provide a good connection between the firm and its environment and to secure its critical resource by attracting new investors and capital funds [2]. Another important benefit of corporate governance is to act as a mechanism of internal governance and monitoring of management. Practicing good corporate governance is an effective tool to help the firm to achieve better performance [2].

IV. CONCEPTUAL FRAMEWORK AND HYPOTHESES

This study aimed to investigate in the relationship between the characteristics of board of directors' and its effect on firm performance? Figure 1 explains the relationship between characteristics of board of directors' and its effect on firms' performance.

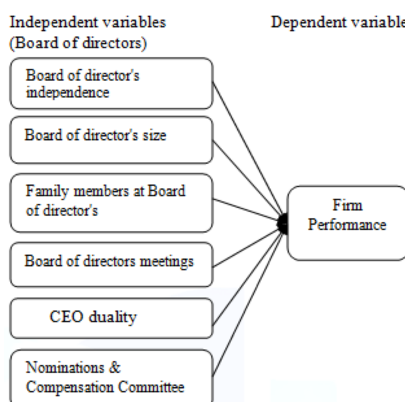

Fig 1; Relationship between board of directors' characteristics and firm performance.

1. *Board of directors independence and firm performance*

Independence of Board of directors are more professional in shareholding firms and can more easily achieve the supervising function, reduce the possibility of collusion of top executives, and prevent the abuse of company resources, thus improving performance [10]. So, Jordanian corporate governance code (JCGC) and Jordanian companies' law focused on the independence of the members of board of directors as a mechanism to overcoming the bias. JCGC stated that at least one third of the board members are independent members [1].

The relation between the proportion of outside directors (board independence), and firm performance is mixed [11]. Numerous of previous studies indicates that board independence arrive to increase firm performance. [12] argued that when the boards dominated by the independents are able to find the best solution to the agency problems between managers and owners and able to monitor the executive decisions. Also, they pointed out that the independents directors prefer to use measurable indicators to assess the performance and what is achieved by the executives. A positive relationship between board independence and firm performance because the existence of greater board independence is a help factor in improving company performance [13].

In spite of the belief that independence of board of directors can lead to improved firms' performance, previous empirical studies examining the relationship between board of directors' independence and firms' performance have reported mixed results. Studies by [14]; [15]; [5], found a positive relationship between independence of board of directors and firms' performance. They gave the reasons that, independent directors being financially independent of management, free of bias, they can protect the rights of shareholders, mitigation of agency problems and provide the monitoring in the best form to manage the firm resources. Board independence leads to the board being better able to replace any executives who breach the accepted managerial code of practice [16].

In contrary, there are studies argued that relation between independent directors and firms' performance is negative. [17] Found there is no relationship between board of directors' independence and firms' performance, especially when independent directors were not selected based on their expertise and experience. [18] Explained that the existence of independent directors minimizing the firms' performance especially in financial crises. [19]; [20] indicated that firm performance is negatively associated with board independence; due to the mechanism of elected the board members or with the lack of experience among boards' members. Therefore, this study expects that:

H1: There is a positive relationship between independence of board of directors and firms' performance.

2. *Board of directors' size and firm performance*

JCGC state that the board of directors whose members shall be not less than five and not more than thirteen, as determined by the Company's memorandum of association 1]. The optimal number of directors represents a problem for companies. Large numbers of directors will lead to reduce the efficiency and performance, because there is an increased difficulty in achieving agreement concerning decisions [10].

The board size is a critical element of achieving the board effectiveness and improves firm performance. Shorter communication distance between members help to increase the efficiency of the board's decision making, so, small boards have positive relationship with firm performance [21]. In a

study in the Jordanian banks, the boards with many members lead to problems of coordination in decision making. So, there is a significant negative relation between board size and banks performance as measured by ROE and EPS but insignificant negative association of board size with ROA. [22].

The board size has negative significant relationship with firm's performance [14]. [23] argued that the Smaller boards are more efficient and faster in decision-making because it is more difficult for the firm to arrange board meetings and for the board to reach a consensus, and when the board size is bigger it will be easier for CEO to have a dominant on the board and increase the CEO power in decision-making.

In contrast, board size have a positive impact on firm performance, especially, with larger board size because it contributes more towards firm performance because larger board size means that there are more ideas and skills that can be shared among board members [24]. Large boards can't monitor or control the agency problem as well as smaller boards [25]. [6] reported that board size is positively related with firm performance. Therefore, this study hypothesizes that:

H2: There is a positive relationship between board of directors' size and firms' performance.

3. Family members at board of directors and firm performance

There is a belief that the family members at the board of directors have a loyalty, belonging and perform better more than other members. Because they have a belief that the firm is their own business and they have a greater knowledge of the firm. Family members prefer to hold positions on the board of directors and appoint a family representative CEO to handle the daily operations of the firm [26].

Firms that have balance in representation between family members and the independent members have been most valuable. In contrast, when the board of directors under the family members and there are few of independent members in the board of directors, the impact on the firm performance will be negatively [27]. Furthermore, family members try to reduce the representation's independent members on the board, while outside shareholders seeking to increase the representations of independent members [28].

In controlling shareholder firms that have a degree of transparent, outside CEOs perform better than founder CEOs, who perform better than heir CEOs. The important thing, under any type of CEOs (Professional, founder, or heir) the transparency and independent should be available [29]. In other words, all of the CEOs should practice a high degree of transparency without any types of bias to any party regardless of their affiliations.

Presence of family members in board of directors, helps the firms achieve higher performance than those managed by outside directors and family ownership creates more value when the founder is as CEO of the family firm or as Chairman with a hired CEO [30]. There is a positive effect on performance for family CEOs in unlisted family firms [31].

Presence of professional managers is more significant in family-controlled firms. Because the firms with situations like bankruptcy or low cash flow need to outside directors who have skills to improve the firms' performance [26]. So, there is no relationship between family directors and firm performance. And there is a negative effect among family directors and performance [4]; [26]. Firm performance has a negative effect on the likelihood that a firm is run by one of its founders [4]. Therefore, this study expects that:

H3: There is a positive relationship between existence of family members at the board of directors and firms' performance.

4. Board of directors meetings and firm performance

Good corporate governance practices require from board of directors should meet regularly to discuss the firm situations, any matter arise, or any new suggestions. So, According to JCGC, The board of directors meetings in the fiscal year must not be less than six meetings. Little number of previous studies is hinted to the board of directors meetings and its impact on firm's performance.

Firms in still lack experiences in managing and supervising, the expected benefits of frequent meetings outweigh the costs. So, board meeting frequency is positively related to firm performance [32]. Frequency of board meetings is considered as a measure of monitoring power and effectiveness of board of directors. Boards of directors that have higher number of meetings through the year their performance will be higher 33]. Where the frequently meetings of board of directors considered one of monitoring procedures that lead to increase firm value [34].

There isn't any effect of the frequency of board meetings on firm performance [35]. Firms with a higher number of Board meetings exhibit the lowest price to book value [36]. Because the big number of meetings is an indicator to the lower efficient of the board of directors and maybe are because the weakness in communication matters between board members is available [36].Therefore, this study hypothesizes that:

H4: There is a positive relationship between frequency of board meetings and firms' performance.

5. CEO duality and firm performance

Agency theory mentioned to be a clear separation among CEO responsibilities and chairman of board of directors. [6], defined the CEO duality as the same person has a position of company CEO and chairman of the board of directors. It's necessary separation among CEO and chairman of the board, because if one person holds the two positions, there would be no other person to monitor his actions and that maybe leads to maximize his own interest at the expense of the shareholders interests then affect on firm performance [37]. JCGC states, 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.

When back to literature that studied the relationship between CEO duality and firm performance results found are mixed. The duality is more effective, because when one person can do effective control over the firm and to be easy make a focus on achieving firm's objectives is realistic and available [38].

There are some of the previous studies confirm that the CEO duality is healthy and more benefit for the firms. The CEO separating process would incur higher costs, and this is maybe bearable for big firms but unsuitable for the small firms

[39]. [40] found a positive relationship between CEO duality and firm performance when measured by Tobin's Q, ROA and operating profit. Also, a study by [41] reported that firm performance is not affected by a separation between CEO and chairman and this means that there is a positive relationship between CEO duality and firm performance.

In contrast, Studies by [6] ; [17]; [42]; [43] found a negative relation between firm performance and CEO dual, they explain that when there is a separation between the chairman and CEOs the performance will be better. They argued that the reason for the duality is a weakness in legal system in internal control unit of firms. Therefore, this study expects that:

H5: There is a positive relationship between CEOs dual and firms' performance.

6. Nominations and Compensation Committee and firm performance

Existence of nomination and compensation committee in the firm is considered as a mechanism to encourage management to run a firm in the interest of shareholders. And these lead to improve the firm performance [7]. This committee plays a significant role in monitor the actions of executive and non-executive directors and ensures that they seek shareholder's interest [44].

The compensation of board members has positive effects on the performance of firms. And it is important to take an appropriate compensation level of board's members. Because the compensation will provide a better relation between shareholders and firm's management and this relation will enhance firm's performance to increase firm's' value [7]. [42] reported that the existence of a remuneration committee has a positive effect on financial performance.

Family members consider firms as an own business, that leading to believe that they have a right to use the firm's resources as they see appropriate. For example, higher salaries or higher compensations and that's may lead to a negative effect on firm performance and causes to losses. So the independence is very important to the committee members [45]. [46] argued that the interaction between independent directors and a compensation committee has significant consequences for CEO incentive systems as well as corporate governance mechanisms.

Previous studies on the existence of a compensation and nominations committee and its effect on firm performance found mixed results. [42] Indicates that presence of the compensation committee have a positive effects on the performance of firms. [47] argued that providing a suitable salary as remuneration have positively effects the motivation of shareholders to increase firm performance. [46] pointed out that board independence produces a stronger relationship between executive compensation and firm performance in Chinese listed firms. [48] found a significant positive relationship between executive cash compensation and Korean shares performance. Therefore, this study hypothesizes that:

H6: There is a positive relationship between existence of nominations and compensations committee and firms' performance.

V. Conclusion

Board of directors is responsible to maximizing the shareholders' wealth and improves firms' performance. To achieve that, vigilant oversight functions should be available and effective by board of directors. Various corporate governance reforms have specifically emphasized on appropriate changes to be made to the board of directors in terms of its composition, structure and ownership configuration till arrive to the best performance and achieving the goals.

The purpose of this study is to examine the importance of one of corporate governance aspects, namely characteristics of board of directors and study its effect in enhance and improve the firms' performance among industrial firms listed on the Amman Stock Exchange. this study propose some of characteristics according to prior studies namely, board of directors' independence, board of directors' size, family members at board of directors, Board of directors meetings, CEO Dual, and nominations and compensation committee.

According to previous studies, when the firms' commitment with the characteristics' of board of directors is consider a significant factor to support and improve the firms' performance. There are some factors supporting this; electing the members according to their experience and qualifications. Should be a clear separation among the positions of CEOs and chairman. Set of committees should be existence to monitor the firm's business such as audit committee and nominations and compensations committee.

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