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Audit Committee and Financial Performance in Jordan: The Moderating Effect of Ownership Concentration

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ABSTRACT

Ownership concentration (OC) can affect a wide range of corporate governance (CG) mechanisms. Jordan is characterized by high OC such as family ownership and managerial ownership. The effectiveness of the audit committee (AC) as one of the major CG mechanisms is affected by OC, which in turn, affects accounting and market-based performance among Jordanian listed companies. Based on this fact, it is believed that OC can moderate the relationship between AC on accounting and market based performance in Jordan. The main purpose of this study is to examine the moderating effect of OC between audit committee effectiveness (ACE) and accounting and market based performance in Jordan. This study used data obtained from 828 firm-year observations of companies listed in Amman stock exchange (ASE) in industrial and service sectors from 2009 to 2017. The findings display that OC has a direct positive effect on ROE and ROA and a negative direct effect on TQ. The results revealed that OC positively moderated the relationship between ACE and ROE as well as ROA. However, OC did not moderate the effect of ACE on Tobin's Q (TQ). Overall, the hypotheses are accepted in terms of ROA and ROE while it is rejected in terms of Tobin's Q. OC only moderated the effect of ACE on ROA and ROE but not on TQ.

INTRODUCTION

Ownership concentration (OC) is an important internal governance characteristic where owners control and dominate the management decisions of a corporate to safeguard their interests (Aprilcilla, 2019). It is a well-established fact that OC affects corporate performance (CP) (Utomo et al., 2019). The link between OC and CP has capture substantial consideration, yet empirical proof remains unreliable.

Certain investigators claim that OC can enhance CP by subjecting the owners to be more enthusiastic or capable of supervising agents or managers (Dakhlallh et al., 2019), while others have contrary views. When the ownership is decentralized, the control influence of owners is reduced over the mangers functionality (Abu Qa'dan & Suwaidan, 2019). Consistent with this, managers as actors can still be monitored and be effective. These actors encompass the audit committee (AC) that form the primary mechanisms in operating a corporate (Nawafly & Alarussi, 2019). AC is considered one of the most crucial CG mechanisms for the corporates listed in stock markets in Jordan. High OC has been indicated to affect the AC role in firms in the Jordanian context (Jaafar & El-Shawa, 2009).

Several empirical studies provide strong evidence of the existence of highly concentrated ownership (Jaafar & El-Shawa, 2009). Abu-Serdaneh et al. (2010) assert that the OC is relatively high among Jordanian listed firms than those in developed markets. This type of control causes agency conflicts between the family board members and the minority stakeholders are more severe in Jordanian companies (Haddad et al., 2015). However, it could lead to expropriate the rights of minority stakeholders. Jaafar and El-Shawa (2009) found average OC to be 54%. This percentage is considered large to the investors, which have a great negative effect on the function of AC and thus affecting CP. Abdullatif et al. (2015) stated that CG mechanisms are ineffective in Jordanian firms because of high OC. Consistent with this, agency theory proposes that CG mechanisms, majorly AC are the key aspect aligning the interest of stakeholders (Bosse & Phillips, 2016). The AC can be 'free-riders' under high OC condition by relying on others (e.g., the influence of family members as board chairperson) to perform their responsibility (Al-Sa'eed, 2018). Thus, the potential capability of OC to acts as a moderating variable between CG and CP since OC can contribute to the intensification of the firm's agency problems.

Despite the influence of OC on the effectiveness of the AC as well as firm performance, the moderating role of OC on accounting and market-based performance in Jordan is largely been ignored by previous studies. Studying this moderating role will strongly help to fully understand and resolve the agency problems in Jordanian firms. Therefore, the objective of this study is to investigate the effect of ACE on the performance as well as to examine the moderating effect of OC on the relationship between ACE and accounting and market performance in Jordan.

1. THEORETICAL BACKGROUND AND HYPOTHESIS DEVELOPMENT

According to agency theory, CG is largely meant to protect the stakeholders' interest in a firm. It is to ensure that managers work towards the maximization of the firm owner's assets by protects against misappropriation of the firm's resources for egocentric interests of managers and firm's employees in general (Shatnawi et al., 2019). The theory was originally proposed by Ross (1973), which explain relationships between two parties. The theory was expounded by Jensen and Meckling (1976) who argue that the separation of ownership from control creates an agency problem, whereby managers operate the firm in line with their own interests, not those of shareholders.

AC efficacy and independence can be influence by OC and thereby affect its relationship with all forms of CP. Alqatamin (2018) investigates whether family ownership affects the positive relationship between AC effectiveness and intellectual capital disclosure. The author found that family ownership lessens the positive relationship between AC effectiveness and intellectual capital disclosure. According to Dakhlallh et al. (2019), when there is a high level of OC, there will be management control thereby affect firm performance. In this regard, there are relatively limited studies that examine the effect of OC on the relationship between AC effectiveness and CP in Jordan. According to Abdullatif et al. (2015), effective AC in Jordanian public listed companies is considered poor due to the effect of OC, which in turn affect CP. The study concluded that these findings can be attributed to the ownership dominant in most Jordanian firms. To improve the relationship, AC must perform its oversight operations (Shatnwai et al., 2020a). An effective AC can help alleviate agency problems in relation to OC by reducing information asymmetry between internal and external CG mechanisms, hence, leads to safeguard the interests of shareholders and enhance CP (Schmalz, 2018).

Studies have revealed that OC plays a significant function in Jordanian companies, particularly, when the corporate decision-makers (i.e., AC) themselves are shareholders or have control and family-owned companies (Almasarwah, 2019). These companies have a large number of relatives or a group from the same family, and occasionally they exercise control over AC and the board of directors. Jordanian corporates are defined as possessing very strong family ties in which owners of corporates appoint family members to moderate/chair the AC and the Boards, even if not competent and still capable of controlling the corporates strategic decisions thereby affecting the effectiveness of the AC (Haddad et al., 2015; Abu Qa'dan & Suwaidan, 2019). Moreover, Idris et al. (2018) investigate whether family ownership weakens the relationship between ACE and cost of debt (i.e., performance). The results suggested that OC decreases the ACE in monitoring the accounting processes and financial processes to provide relevant and credible information to the firm's stakeholders. Based on these arguments and empirical evidence provided by the earlier studies, this study expects that the relationship between AC and CP can be moderated by OC in the Jordanian industry and service listed companies. The testable hypothesis is stated as:

- H1: AC effectiveness has a positive significant effect on the CP in the Jordanian industry and service listed companies.
- H2: OC moderates the relationship between the ACE and CP in the Jordanian industry and service listed companies.

Figure 1 presents the research framework of this study based on the theoretical framework explained above.

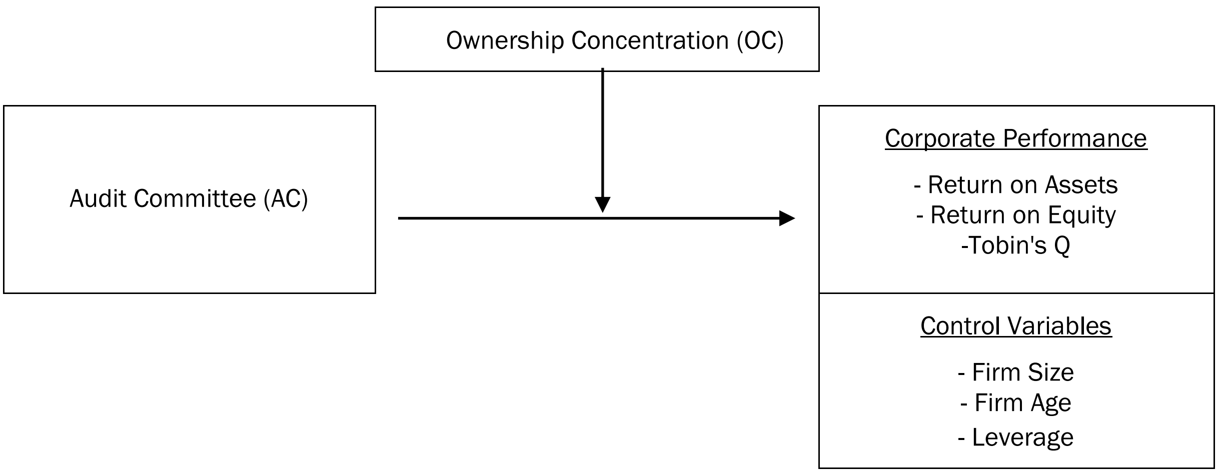

Figure 1: Research Framework

Source: self-developed

2. METHODOLOGY

This study used a quantitative approach. This study uses a descriptive type of research design in fulfilling the objective, that is, examining the CG mechanisms and CP in the Jordanian industry and service listed companies. The design is used to test the relationship between ACE on CP and OC as a moderating variable in the Jordanian industry and service listed companies. The collection of data to accomplish objective are derived through secondary data obtained through published annual reports from Amman Stock Exchange website as well as the respective companies' websites from the years 2009 to 2017.

The current study uses data from 2009 to 2017 as a result of the implementation of the CG policy in Jordan, which was initiated in 2009. The year 2017 was chosen as the end date for the period under study because some companies were delisted in 2018. The three sectors under Amman stock exchange (ASE); financial, industrial, and service sectors were divided into 101, 46, and 46 firms, respectively (ASE, 2018). However, this study uses only two sectors industry and sector service. This led to 828 firm-year observations for the whole sample (92 firms multiplied by 9 years). Thus, companies in the financial sector were excluded because they have different CG rules issued by the Insurance Authority and the

Central Bank of Jordan (Al-Akra et al., 2009). The SPSS and STATA (version 16) are software used for the data analysis.

2.1 Moderating Variable

OC has been measured in many different ways. Many of the previous studies have used the top ten largest, the top five largest or the largest shareholders as a proxy for OC (Nawafly & Alarussi, 2019). According to Ishak et al. (2010), the concentration of ownership was measured by the percentage of shares held by the single largest shareholder relative to the total number of shares in the company. In this study, OC was measured by the total percentage of shares owned by investors who own five percent (5%) and more of the total company shares (Al-Saidi & Al-Shammari, 2015).

2.2 Control Variables

This study includes control variables in order to increase the confidence of the results. In fact, CP as a dependent variable might be influenced by other factors other than the independent variables. The control variables are commonly used to explain the variation in CP. A set of these control variables are generally included in the regressions. To measure the effectiveness of the AC on CP, the study considers a number of control variables that may have an effect on CP. This research depended on the literature and the available data for control variable selection. This study used three control variables: firm size, firm age, and leverage.

In terms of firm size, larger firms have a better opportunity than the smaller ones in creating and generating funds internally as well as accessing external resources (Short & Keasey, 1999). Larger firms perform better than smaller ones owing to their capacity to achieve risk diversification. However, Agrawal and Knoeber (1996) reported a negative relationship between firm size and CP. Firm age is measured by the number of years from the time the firm is established. Firm age has been associated with several decisions of firms (Boone et al., 2007). New companies are anticipated to have smaller earnings than older companies because they have less experience in the market and are still building their market position, and generally have a greater cost structure (Halling & Zechner, 2016). Leverage is the utilization of borrowed funds or debt in an attempt to enhance CP. In this study, leverage is equal to the ratio of total liabilities divided by total assets (Lazzem & Jilani, 2018). The leverage ratio is considered as a vital factor affecting CP (Zahra, 1995).

2.3 Performance Measures

Previous studies have suggested a range of accounting-based measurements such as the Return on Assets (ROA) and Return on Equity (ROE). Tobin's Q is the most commonly utilized measure for reflecting market-based performance (Alaaraj et al., 2018). Tobin's Q shows how investors regard the firm and it is a relevant indicator of company survival. The market-based performance takes into account stock prices, which highlight the firm data's economic value. In this study, the ROA is measured as net income divided by total assets' book value (Eldaia et al., 2020), which measures profitability and the most common accounting ratios used in the financial analysis. ROE is measured as net income divided by the equity of the shareholder (Arslan et al., 2010), which measures the return on the stakeholders' equity and the firms' efficiency at making profits. Tobin's Q is assessed as the market value of equity plus the book value of the debt, divided by the book value of the total assets (Bauer et al., 2004), which is a proxy that measures firm performance including market share, and profit achievement.

2.4 Panel Data Estimation and Research Model

The current study is based on 828 sampled companies over a nine-year period. Therefore, it is appropriate to use a panel data approach to examine the effect of the independent variables on CP practice. The panel data approach has been previously adopted by studies (Siam, 2018; Idris et al., 2018). Accordingly, Hsiao (2014) documented that panel data provides a study with a large quantity of data, which maximize the scale of freedom and minimizes the collinearity through independent variables. Various advantages can be gained from using panel data. For instance, this type of data can control the level of individual heterogeneity, has more efficiency, more degrees of freedom, lower collinearity among the variables, and more variability, can control the extent of the impact of omitted variables, and it is more informative (Hsiao, 2014).

2.5 Regression Analysis for Moderating Effect

The moderating effect or interaction effect occurs when the moderator variable changes the form or the strength of the relationship between two or more variables (Hair et al., 2010). Hartmanna and Moers (2003) pointed out that regression analysis is more suitable for testing a hypothesis that contains moderating variables. The moderating relationship consists of three types of variables: the dependent variable, the independent variable, and the moderator variable. In a moderating relationship, the dependent variable is influenced by the independent variable and a moderating relationship exists when the influence of the independent variable on the dependent variable is different depending on the value of the moderator variable (Aprilcilla, 2019). To investigate the direct effect of AC and the moderating effect of OC between AC and performance, the study applies the following regression analysis:

$CP = \alpha + \beta_1 \text{ ACE\_SCORE}it + B_2 FSIZE + B_3\ FAGE + B_4\text{LR} + u_{it}$ (1)

$CP = \alpha + \beta_1 \text{ ACE\_SCORE}it + \beta_2 \text{ OC } it + \beta_3 \text{ ACE-SCORE * OC it} + \beta_4 FSIZE + \beta_5\ FAGE + \beta_6 \text{ LR} + u_{it.}$ (2)

Source: self-developed

3. RESULTS AND DISCUSSION

This study deploys composite to measures AC Effectiveness (ACE) because it is suitable to evaluate the moderating role of OC, where hierarchical regression have been commonly used to perform this analysis (Al-Matari et al., 2014). Using the hierarchical regression, first, the direct effect model is tested which includes only the independent variables ACE and the control variables of firm size (FA), leverage (LG), and firm age (FA). Subsequently, the moderating variable OC is included in the Model. Following the same procedures, interaction effect with OC are created (ACE*OC). Hair et al. (2010) and Siam et al. (2018) suggested the testing of one moderating variable in the model gives results that are more accurate. The results of the tested moderating variable are presented. Table 1 shows the results of tested OC as a moderating variable between ACE and ROA. It can be observed that there is a change in the R-square and the F-statistics is significant for the model.

Table 1. Result of the Moderating effect of OC between ACE and ROA

ROA	*Coef.*	*t-statistics*	*P>t*
C	1.17	12.4	0.000
ACE	.191	2.92	0.004
OC	.112	2.63	0.009
ACE*OC	-.075	-1.75	0.068
FS	.980	10.8	0.000
LG	-.156	-3.34	0.001
FA	-1.09	12.4	0.000
R-square	.414		
F statistic	32.88***		

*** significant at 0.001, ** significant at 0.05, *significant at 0.10

Source: Data analysis

For the moderating effect of OC between ACE and ROE, Table 2 shows the results of the tested moderating effect. Minor changes have been observed in the r-square while the model has significant F-statistics indicating that the model is significant in predicting the dependent variable.

Table 2. Result of the Moderating effect of OC between ACE and ROE

ROE	*Coef.*	*t-statistics*	*P>t*
C	.589	5.87	0.000
ACE	.511	7.37	0.000
OC	.128	2.84	0.000
ACE*OC	-.088	-1.88	0.077
FS	.177	1.84	0.066
LG	.195	3.93	0.000
FA	-.203	-1.32	0.187
R-square	.393		
F statistic	28.93***		

*** significant at 0.001, ** significant at 0.05, *significant at 0.10

Source: Data Analysis

The third dependent variable is Tobin's Q. Table 3 shows the results of a tested moderating effect of OC between ACE and Tobin's Q. The changes in the r-square are small and the F-statistics for the model are significant.

Table 3. Result of the Moderating effect of OC between ACE and TQ

TQ	*Coef.*	*t-statistics*	*P>t*
C	-.198	-1.73	0.084
ACE	-.171	-2.17	0.030
OC	-.345	-6.94	0.000
ACE*OC	.011	0.31	0.760
FS	.419	3.82	0.000
LG	-.164	-2.91	0.004
FA	-.290	-1.66	0.098
R-square		.381	
F statistic		21.3***	

*** significant at 0.001, ** significant at 0.05, *significant at 0.10

Source: Data Analysis

According to the hypothesis of this; OC moderates the relationship between the ACE and CP in the Jordanian industry and service listed companies. To test the hypothesis, the moderating effect of OC between ACE and the three dependent variables (ROA, ROE, and Tobin's Q) tested, it was found that the direct effect of ACE on ROA in the Model is positive and significant. The interaction between ACE and OC is negative and significant. These findings indicate that when the OC moderation decrease, the positive effect of ACE on ROA increases. When the dependent variable changed to ROE, the findings indicated that the interaction between ACE and OC is negative and significant indicating that OC as a moderating variable has an effect on the relationship between ACE on ROE. The findings showed that the interaction between OC and ACE is positive but insignificant. The OC positively moderated the relationship between ACE and ROE as well as ROA. However, OC did not moderate the effect of ACE on Tobin's Q. The high OC in Jordan could be the reason behind the negative moderation.

When OC is high, the decision-making is concentrated on the CEO, who usually the owner of the company and this makes the AC ineffective. It is that in the companies where the OC is high, the AC role becomes weak (Siam et al., 2018). The OC is in the form of high family OC and high OC among the board members. When the functions of the AC are negatively affected, this reflects on the company's market performance. These findings are in line with previous studies reported by Hartmanna and Moers (2003), and who found that OC negatively moderated the relationship between ACE and ROE as well as ROA. However, the result of the insignificant moderating effect of Tobin's Q is not in agreement with findings reported by Idris et al. (2018). This may because the independence of AC is influenced by family control, which affects their efficacy in discharging their primary role in making a big decision on the firm market activities in Jordan, which in turn affects the market performance. In general, this study hypothesis is accepted in term of ROA and ROE while it is rejected in term of Tobin's Q. OC only moderated the effect of ACE on ROA and ROE but not on TQ

On the other hand, Agency theory asserted that high OC reduces the agency problem because the owner act as the manager and this reduces the conflict of interest as well as the cost of management. This is because it increases the CP but reduces the effectiveness of AC (Bosse & Phillips, 2016). The OC in this study was found to have a negative direct effect on Tobin's Q, which could be explained by the fact that companies with high OC were not preferable to the investors and shareholders thereby make the market has a negative reaction to this type of companies because ACE is less effective in such companies.

Family and managerial ownership is high in Jordan making the TQ of the companies low and this affecting the market performance of the companies. This findings suggest that decision makers have to increase the role of ACE by allowing more independence AC member to join the AC and to emphasis on the effective role of AC in forming the decision of the companies.

CONCLUSION

The findings showed that OC negatively moderated the effect of ACE on ROA and ROE but not on TQ. The findings were more into the fact that OC has a direct positive effect on ROE and ROA and a negative direct effect on TQ. In general, this study hypothesis is accepted in terms of ROA and ROE while it rejected in terms of Tobin's Q. OC only moderated the effect of ACE on ROA and ROE but not on TQ.

There are some limitation in this study. First, the study was based on the secondary data collected from industrial and service companies in Jordan. There was some pproblems such as incomplete data or non-responses due to problems related to some design and data collection. To overcome these problems, this study uses official websites of the selected companies to acquire the appropriate data and annual reports. The second limitation is related to measurement errors, which may arise because of inappropriate information and/or the misreporting of data. Therefore, in this study, all the indicators used in the measurements are taken from the annual financial statements of ASE listed firms. These statements are audited and published, which reduces the chance of measurement errors. The study included OC which includes family, managerial, governmental, and foreign ownership. Further studies are needed to examine the moderating role of each type of ownership.

Further studies also need to consider other variables of CG such as the board of director and the CEO characteristic to increase the variation in the CP of companies in Jordan. Other sector can be investigated such as the financial sector. Decision makers can benefits from this study to improve the performance of companies in Jordan.

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