

## The Effect of Effective Corporate Governance Structure in Improving Investors' Confidence in the Public Financial Information

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### Abstract

The primary goal of corporate governance is to create a balance of power-sharing among shareholders, directors, and management to enhance shareholder value and protect the interests of other stakeholders. Effective corporate governance structure improves investor confidence, it ensures corporate accountability, enhances the reliability and quality of public financial information, and enhances the integrity and efficiency of the capital market. The study has covered 10 public companies in Jordan. Resolution data were analyzed using the statistical program (SPSS), in addition to other statistical methods. The study concluded that corporate governance in the Jordanian public companies is effective because it is complying with state and federal statutes, complying with listing standards, and implementing best practices suggested by investor's activists and professional organizations. Also the study recommended to maintain the current level of investors' confidence and to work on developing the legal framework for corporate governance in the light of the proposed development of a conceptual framework, and finally encouraging accounting, administrative, economic and legal research and studies, that leads to the best practices to meet the governance requirements.

**Keywords:** Corporate governance, Investors' confidence, Corporate accountability, corporate culture.

### Introduction:

Corporate governance is a process affected by legal, regulatory, contractual, and market-based mechanisms and best practices to create substantial shareholder value while protecting the interests of other shareholders (Wikipedia, 2013). In a capital structure where there is a concentrated ownership and a small group of shareholders can exercise ownership control, corporate governance should ensure alignment of the interests of controlling

shareholders with those of minority or individual shareholders (OECD,2004). As it's mentioned earlier that effective corporate governance structure improves investor confidence, ensures corporate accountability, enhances the reliability and quality of public financial information, and enhances the integrity and efficiency of the capital market, it means that there is a relationship between corporations and the capital markets. This relation is existed because capital markets provide funds to corporations and thus monitor their corporate governance to align the interests of management with the interests of investors. On the other hand, corporations provide relevant financial information to the capital markets, which facilitates the efficiency and liquidity of the capital markets (D Bagchi, 2011).

Corporate governance reforms and best practices require the establishment of four key gatekeepers to deal with the perceived agency problems of asymmetric information between management and investors and to improve the quality of public financial information, (1) Independent and competent board of directors; (2) independent and competent external auditor; (3) objective and competent legal counsel; and (4) objective and competent financial advisors and investment bankers (Devinney & Schwalbach & Williams, 2013). The role of a corporate governance gatekeeper is to align management's interests with those of long-term shareholders and to protect investors from misleading financial information published in public filings. Misleading financial information could lead to failure of these corporations.

In addition to policies and procedures designed to promote effective corporate governance, organizations must create and reinforce a consistent, positive corporate culture which complements such measures. Members of the organization, starting with the executives, must lead by example in their efforts to encourage others to comply with applicable policies and procedures. The norms and values embraced by the organization as its corporate culture should be consistent with its policies and procedures; otherwise behavior inconsistent with those policies and procedures will result in losing confidence in these corporations.. Compliance just for the sake of compliance and the development of a "check box" mentality is not enough (**Lori A. Richards, 2012**). In order to achieve the objective of this research, we should measure and determine the conditions of effective corporate governance as a whole package not by a particular element, meanwhile other studies referred to the subject by particular corporate governance effect.

As all the developing countries in the world, the public sector in Jordan is facing lack of trust and confidence by the investors. Investors doubted financial information, the capital market, the integrity and efficiency of public corporations. In Jordan, figures taken from Companies Control Department CCD indicate that the cumulative number of companies that have been terminated until the end of June 2012 amounted to (28808) company, with total capital of (545) million Jordanian dinars, and a large number of these companies have been dissolved and suffered both loss of the entire capital and the erosion of the rights of its shareholders. The reason behind that is mainly due to mismanagement. A number of these companies have been converted to judicial authorities or to compulsory liquidation as a result of violating law provisions. The current study will try to answer whether the public corporate governance in Jordan is effective or not. Effective corporate governance means compliance with state and federal statutes, compliance with listing standards, and implementation of best practices suggested by investors' activists and professional organizations.

Corporate governance is of paramount importance to a company and is almost as important as its primary business plan. When executed effectively, it can prevent corporate scandals, fraud and the civil and criminal liability of the company. It also enhances the confidence of investors. A corporation without a system of corporate governance is often regarded as a

body without a soul or conscience. Corporate governance keeps a company honest and out of trouble. If this shared philosophy breaks down, then corners will be cut, products will be defective and management will grow complacent and corrupt, and finally investors will lose confidence in the corporation and in its financial information. The matter of investor's confidence is very important to be explored and investigated before a decision of investment is taken especially in the public sector.

This study aims to measure the effect of effective corporate governance structure in improving investors' confidence in the Public Sector. Effectiveness means that the firm complying with state and federal statutes in improving investors' confidence in the Public sector, also the firm is complying with listing standards in improving investors' confidence in the Public sector, and finally the firm is implementing the best practices suggested by investors activists and professional organizations in improving investors' confidence in the Public sector.

***Literature Review:***

Corporate governance is a set of rules that define the relationship between stakeholders, management, and board of directors of a company and influence how that company is operating. At its most basic level, corporate governance deals with issues that result from the separation of ownership and control. But corporate governance goes beyond simply establishing a clear relationship between shareholders and managers (CIPE: Development Institute, 2013).

Many financial scandals occurred during the last decades which lead to the raise of regulatory acts trying to reform the accountability structure of these corporations. The Sarbanes-Oxley act was one of these acts passed intending to restore public confidence in corporate governance. The Sarbanes-Oxley (SOX) act has encouraged management to effectively formulate and implement a strong system of internal control and financial reporting such that errors and fraud are materially prevented, detected, and corrected. One of the recent research has examined one of the Sarbanes-Oxley act requirement which is the certification of the financial statement by the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO) by surveying stakeholder constituent groups to determine whether this new requirement is effective in accomplishing the goals established. The research found out that there are significant differences among the perceptions of the constituent groups as to the effectiveness of this requirement (Engebretson & Meier, 2011).

The presence of strong governance standards provides better access to capital and aids economic growth. Corporate governance also has broader social and institutional dimensions. Properly designed rules of governance should focus on implementing the values of fairness, transparency, accountability, and responsibility to both shareholders and stakeholders. In order to be effectively and ethically governed, businesses need not only good internal governance, but also must operate in a sound business environment. Business environment itself should obviously be both the promoter and the beneficiary of corporate governance, properly overtaken and applied, in the broadest sense of leadership the corporate governance gives while covering a lot of meanings, approaches, interests, concerns, and possible solutions (Nicolaescu, 2012).

Elements such as secure private property rights, functioning judiciary, and free press are necessary to translate corporate governance laws and regulations into on-the-ground practice. Internal and external corporate governance mechanisms exist to aid and improve corporate governance. Internal mechanisms are designed to manage, direct, and monitor

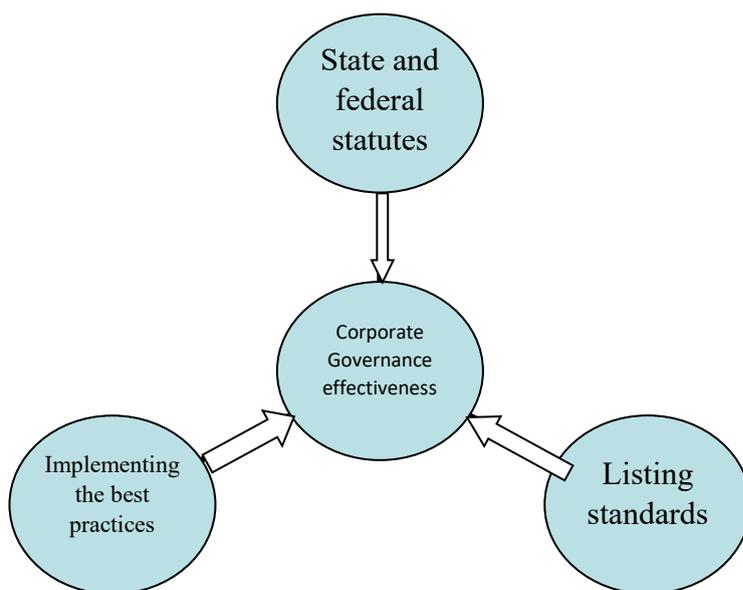
corporate activities in order to create sustainable and enduring stakeholder value. Examples of internal governance mechanisms are the board of directors, particularly independent directors, the audit committee, management, internal controls, and internal audit functions. One of the recent researches concentrated on studying the effect of Internal Audit Report (IAR) on investor confidence done by (Holt & DeZoot, 2009), the research evaluates the extent that a descriptive IAR affects investor confidence and investment decisions. The results indicate that participants provided with an IAR had more confidence in financial reporting reliability and higher perceived company oversight effectiveness than participants without access to an IAR. The IAR effect on confidence in financial reporting reliability is particularly evident for high fraud risk companies. On the other hand external governance mechanisms are intended to monitor the company's activities, affairs, and performance to ensure that the interests of insiders (management, directors, and officers) are aligned with the interests of outsiders (shareholders and other stakeholders). Examples of external mechanisms are the capital market, the market for corporate control, and the labor market, as well as state and federal statutes, court decisions, shareholder proposals, and best practices of investor activists. These mechanisms may be helpful in aligning management incentives with shareholder interests, and also controlling management behavior. Corporate governance mechanisms may be ineffective in situations in which independence is removed, or in which corporate governance participants fail to perform their duties.

Generally there are three aspects of corporate governance. The shareholder aspect of corporate governance is the concept that the corporation exists for the benefit of shareholders, and therefore, emphasizes shareholder value creation and enhancement as the primary objective of corporations. The shareholder aspect of corporate governance is based on the premise that shareholders provide capital to the corporation which exists for their benefit. It supports the agency theory that fiduciary duties of corporate directors and executives are to shareholders who have a residual claim on the company's residual assets and cash flows. Shareholders (principals) provide capital to the company, which is run by management (agent). The principal agent problem exists because corporations are separate entities from their owners, management needs physical capital (investment funds) and investors need skilled human capital to run the company. The stakeholder aspect of corporate governance is the premise that a company's success depends on the contributions of investors and other key groups and how well it manages the relationships with those groups which consist of shareholders, creditors, employees, suppliers, customers, and communities. The stakeholder model of corporate governance focuses on a broader view of the company as a nexus of contracts among all corporate governance participants with the common goal of creating value. The emerging model concentrates on maximization for all stakeholders, including: (1) contractual participants such as shareholders, creditors, suppliers, customers, and employees; and (2) social constituents including the local community; society and global partners; local, state, and federal governments; and environmental matters. Under this view, public companies must be socially responsible—good citizens granted the use of the nation's physical and human capital, managed in the public interest. The integrated aspect of corporate governance focuses on both shareholder value creation and enhancement and stakeholder value protection. Modern corporate governance emphasizes both financial aspects of increasing shareholder value and an integrated approach that considers the rights and interests of all stakeholders. Corporate governance should be viewed as a dynamic and

integrated approach of addressing financial, social, environmental, and economic concerns of all stakeholders (Wiley, 2013).

Corporations should create an ethical culture that encourages all corporate governance participants including directors, officers, auditors, financial advisors, employees, and others to do the right thing and understand that this is vital to the company's sustainable financial performance. Recent research has addressed the gap between public policy and the corporate governance literature in accounting by studying the effectiveness of a code of ethics. The research predicted that a code of ethics will improve manager return behavior and investor confidence to the extent that it activates social norms that control opportunistic behavior. The research found out that when the code is present but there is no certification choice, manager returns behavior does not improve and investor confidence erodes over time because of increased expectations that are not met by managers (Davidson & Stevens, 2013). Good corporate governance ensures that the business environment is fair and transparent and that companies can be held accountable for their actions. Conversely, weak corporate governance leads to waste, mismanagement, and corruption. It is also important to remember that although corporate governance has emerged as a way to manage modern joint stock corporations it is equally significant in state-owned enterprises, cooperatives, and family businesses. Regardless of the type of venture, only good governance can deliver sustainable good business performance. (CIPE: Development Institute, 2013).

### ***Research Design***



Research design is formed out of three elements which constitute the main factors to form effective corporate governance. These elements are the main hypothesis of the study.

#### **Research Methodology**

The primary data needed for the study objectives were collected through a survey conducted on the traders in Amman Stock Exchange Market during the year 2013. The number of questionnaires distributed were (50) questionnaires. Resolution data were analyzed using the statistical program SPSS, in addition to other statistical methods. Quantitative data were collected using a self-administered questionnaire, in which the traders were asked to state the likelihood (on a 5-point scale: [5] strongly agree; [4] agree; [3] neutral; [2] disagree; [1] strongly disagree). Other Data is collected from secondary sources. Secondary data is collected from articles published by the well-known periodicals, books, websites and dissertations.

#### **Study Hypothesis:**

H0: The investors have no confidence in the public sector because of its ineffective corporate governance practices. The sub divided hypothesis which can be derived from the first hypothesis can be set as follows:

- a. Corporate governance is not effective because it does not comply with state and federal statutes.
- b. Corporate governance is not effective because it does not comply with listing standards.
- c. Corporate governance is not effective because it does not implement best practices suggested by investor's activists and professional organizations.

#### **Study Community:**

The study community is formed out of the traders in Amman Stock Exchange Market as they form the potential investors in the public sector. 50 copies of the questionnaire were delivered by hand on the respondents, 36 copies were returned ( percentage of 72% ); these

36 copies were accepted and used in the pilot analysis of the original distributed copies, Table (1) shows these results.

Table (1): Items	No.	Percentages
Questionnaires Distributed	50	100%
Questionnaires recovered	36	72%

**Statistical Analysis:**

Many statistical measures was used to analyze the questionnaire, such as, Arithmetic mean, standard deviation, frequencies, t test, and percentages, for the purposes of description and analysis of the study data. The Statistical Methods used can be summarized as follows:

- 1- Descriptive Analysis: Arithmetic mean, standard deviation, and percentages, are the main tools of this type of analysis.
- 2- Cronbach Alpha: This measure was used to test the reliability, and the credibility of the study. As (Sekaran, 2003), explained, Internal reliability coefficient between answers that statistically acceptable, if the value for this measure is (60%) or more.

The result showed that, the reliability coefficient is high, which indicates that, the questionnaire is reliable. The total reliability coefficient values (internal consistency) using Cronbach Alpha equals 93.9%, which is a high value, and suitable for the objectives of the study.

**Data Analysis of the Demographic Characteristics of the Respondents:**

Table(2), illustrates the demographic characteristics distribution of the study sample.

Table(3): Variable	Group	Frequencies	%
Sex	Male	25	69.4
	Female	11	30.6
Total		36	100%
Age	Less than 25 years	4	11
	From 25 years—35 years	17	47
	More than 35 years—45 years	9	25
	More than 45 years	6	17
Total		36	100%
Professional Certificate	CMA	3	9
	Bachelor Degree	25	69
	Other	8	22
Total		36	100%
Job Title	Head of Investing department	5	14
	Officer in an Investing Department	9	25
	Broker	13	36
	No title	9	25
Total		36	100%
Experiences	Less than 5 years	5	14
	From 5 years – 10 years	14	39
	More than 10 years – 15 years	9	25
	More than 15 years	8	22
Total		36	100%

**Data Analysis of the Study:**

The arithmetic means and the standard deviation has been calculated of all study questionnaires.

Table (3) illustrates compliance with state statutes results:

No.	Table (3): Compliance with state statutes.	A. Means	S. Deviation	Order
1	Each company has the right to object when another company is registered of a similar name to the name it has which may lead to confusion or fraud	4.08	0.69	high
2	Companies must provide proper accounts for the company's business, information and monitoring data periodically and whenever asked.	3.66	0.75	high
3	The members of the Board of Directors should provide a statement of any account benefited obtained or possessed either in cash or kind of any practical relation related the company.	3.69	1.01	high
4	The authorized signatory Director may be removed from his position either by the approval of all members of the Board of Directors or by the majority.	3.75	0.73	high
5	Management must prepare the annual financial report of the Company fully audited. And should be submitted before the end of the first three months of the new fiscal year and also provide a copy to company's observer.	4.02	0.84	high

6	It is Prohibited that, the Chairman of the Board or any member of the board of directors to have a job or be a members in another similar company, without the approval of the extraordinary general assembly.	3.77	0.79	high
7	The board of directors is committed to invite the shareholders to its annual meeting during the first four months of the new financial year to discuss the following matters: • The annual report .The auditors' report .The annual budget • Election of Board Directors.	3.61	0.90	high
8	A company may redeem its share capital throughout an announcement in local newspapers. Creditors have the right to object to the reduction procedures by informing the Controller.	3.44	0.73	high
9	Shareholders have the right to annual dividend upon the decision is taken by the Board. And they have the right to receive dividends within (60) days from declaration date, or from (45 ) days from the date of record.	3.69	0.71	high
	Total	3.75	0.45	high

Table(4) illustrate compliance with listing standards results:

No.	Table(4): Compliance with listing standards.	A. Means	S. Deviation	Order
1	The corporate governance framework should protect shareholders' rights to secure methods of ownership registration	3.97	0.77	high
2	The corporate governance framework should protect shareholders' rights to convey or transfer shares	3.97	0.84	high
3	The corporate governance framework should protect shareholders' rights to obtain relevant information on the corporation on a timely and regular basis	3.72	0.61	high
4	The corporate governance framework should protect shareholders' rights to participate and vote in general shareholder meetings.	3.88	0.74	high
5	The corporate governance framework should protect shareholders' rights to elect members of the board	3.66	0.75	high

6	The corporate governance framework should protect shareholders' rights to share in the profits of the corporation	3.80	0.57	high
7	Shareholders have the right to participate in, and to be sufficiently informed on, decisions concerning fundamental amendments to the governing documents of the company.	3.52	0.55	high
8	Shareholders have the right to participate in, and to be sufficiently informed on, decisions concerning the authorization of additional shares	3.75	0.60	high
9	Shareholders have the right to participate in, and to be sufficiently informed on, decisions concerning extraordinary transactions that in effect result in the sale of the company.	3.94	0.67	high
10	Shareholders should have the opportunity to participate effectively and vote in general shareholder meetings and should be informed of the rules, including voting procedures that govern them.	3.94	0.75	high
11	Shareholders should be furnished with sufficient and timely information concerning the date, location and agenda of general meetings, as well as full and timely information regarding the issues to be decided at the meeting.	3.91	0.60	high
12	Opportunity should be provided for shareholders to ask questions of the board and to place items on the agenda at general meetings.	3.97	0.73	high
13	Shareholders should be able to vote in person or in absentia, and equal effect should be given to votes whether cast in person or in absentia	3.86	0.59	high
	Total	3.84	0.45	high

Table(5) illustrate implementing best practices suggested by investor's activists and professional organizations results:

No.	Table (5): Implementing best practices suggested by investor's activists and professional organizations.	A. Means	S. Deviation	Order
1	The need to reject the idea of conflict of interest between groups concerned with the company and, in particular, shareholders and the board of directors and executive management .	4.08	0.77	high

2	The need to drop the principle of self-interest, and always upholding the principle of the company's interest.	3.5	0.61	high
3	The need to develop the legal framework for corporate governance in the light of the proposed development of a conceptual framework.	3.91	0.76	high
4	Suitable recommendations are provided in order to improve the working processes.	4.11	0.74	high
5	Tougher penalties should be implemented for violating the administration Assembly Resolutions of the shareholders, as well as violating the basic system of the company, and the non-implementation of the recommendations of the Audit Committee.	3.83	0.56	high
6	Tighten sanctions should be implemented for violating the auditor standards of the profession and, in particular, accounting standards, and the standard of independence, and the standard of due care professional.	3.94	0.62	high
7	Encourage accounting, administrative, economic and legal research and studies, that leads to the best practices to meet the governance requirements	3.94	0.67	high
	Total	3.90	0.52	high

### **Results and test hypotheses using multiple regression:**

Table (6) illustrates sample test results, (One Sample t-test) to examine the main hypothesis.

Table (6): Hypothesis	Arithmetic Means	Calculated t	Tabular t	Sig	Result
Compliance with state statutes	3.75	9.92	2.04	0.000	Reject
Compliance with listing standards	3.84	11.18	2.04	0.000	Reject
Implementing best practices suggested by investor's activists and professional organizations	3.90	10.283	2.04	0.000	Reject

It is noticed from Table (6) that the value of (t) calculated, concerning first, second, and third sub hypothesis that, the level of significance is (0.000), and the calculated (t) is higher than tabulated (t). As the value of (t) calculated is higher than tabulated (t), we reject H<sub>0</sub> hypothesis. which means that, corporate governance is effective because it complying with state and federal statutes, with listing standards, and it is implement best practices suggested by investor's activists and professional organizations. Finally, we can conclude that, the investors have confidence in the public sector because of its effective corporate governance practices.

**Conclusions & Recommendations:**

According to Data Analysis, and Hypothesis testing the study had concluded the following: The investors have confidence in the public sector because of its effective corporate governance practices. This confidence is attributed to conclusion derived from the first sub hypothesis which is, corporate governance is effective because it is complying with state and federal statutes. Also confidence is attributed from the second sub hypothesis which is, corporate governance is effective because it is complying with listing standards. Finally, corporate governance is effective because it implementing best practices suggested by investor's activists and professional organizations.

According to the study conclusions the researcher recommend the following:

To maintain the current level of investors' confidence, public sector should keep its current governance practices under continuous evaluation process, through developing the legal framework for corporate governance in the light of the proposed development of a conceptual framework, also through suitable recommendations in order to improve the working processes, and finally encouraging accounting, administrative, economic and legal research and studies, that leads to the best practices to meet the governance requirements.

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