



## The Influence of Corporate Governance on cash holdings; Empirical evidence from Jordan.

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### Abstract

The basic purpose of the current study to test the influence of corporate governance (CG) on companies' cash holding in Jordan. For this purpose, study use the penal data which was taken from the annual reports of the Jordanian manufacturing listed companies on Amman Stock Exchange (ASE). Data was collected 26 companies out of 69 manufacturing companies over the period of five years 2008 to 2012. The results of the study indicate, BOS, BOI, and CEO\_D is significantly link with the cash holding of companies. The current study finding showing the importance of the CG which may be help to policy maker and practitioners to recognized the influence of CG. Future studies should consider more elements of the corporate governance.

**Keywords:** Influence of Corporate Governance, Cash Holdings

### Introduction

From the past few years, the critical problem to select suitable cash level in companies. It is highlighted in previous literature of finance the main three objects of holding cash, one is transaction object: cash need by a company to encounter the daily business activities, second is precautionary object: meet the contingencies and lastly speculative object: which get the advantage of bargain purchase which may increase in the coming future days. Optimal cash holding level is the essential of adequate liquidity. The liquidity shows the company in situation to encounter its short term liabilities as they fall due. Eventually risk connected with illiquid that collectors may be approved court letter to liquidate the company. Consequently, every company sustain maximum cash balance to meet daily activities. The top managers should see the aspects influencing the cash balance at different period of time. The gurus of the finance suggested that the total cost of additional cash and hazards of insufficient cash should be equal to arbitrate the optimal cash level of balance (Pandey, 2015). The different reasons in company to hold the cash; meet up liabilities, to license the operations, and to caught the better investment chances (Wai, 2013).

Moreover, optimal cash level performs as a shield to save greater opportunity costs when the cash deficiency in the company (Ozkan, and, Ozkan , 2004: Opler, et, al , 1999). This is actually realized that the companies in services sector is much prone to sustain cash funds for the aim of training and research activities. On the other side, the manufacturing companies might be need cash for the operational as well as capital expenditures. So, assumed that cash holding requirement are depending on the distinct companies' same requirements and type of businesses. That's why, to achieve these companies exact requirements, accessibility of necessary cash is significant for each going concern but till different costs and assistances are also related with cash holding. According to this view, companies are need to sustain the maximum cash level. In this study, according to Masood, and Shah, (2014) supposed that CG strong by companies is important to sustain maximum level of cash. The CG define as "the system through which businesses are directed and controlled" (Isaksson, 1999). While, La Porta et al. (2000) indicated that "corporate governance is a set of mechanisms through which outside investors protect themselves against expropriation by the insiders". The insider more describes as managers and predominating stakeholders of the companies. It is highlighting that good CG mechanism effects the camp0iness cash holding to maximum level. Hence, the current research expands the previous literature on the influence of CG on cash holding of non-financial companies. Thus, it projected that the current study gives contribution geographically to the previous researches.

Most of the pervious researcher examine the CG effects on companies' cash holding in advance countries with greater environment of business. On the other side, developing countries very few researches to explore the Arab countries particularly in Jordan. So, it is very hard to detect the corporate governance and cash holding relationship, and also different viewpoint on CG



and its influence in cash holding. Consequently, the current study expected to fill this research gap.

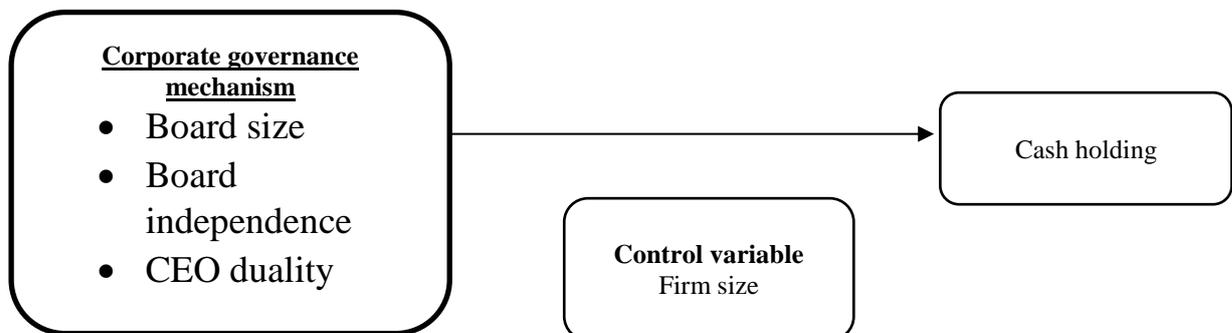
**Literature review**

The mix finding have been cited in the previous researches on the relationship between the CG and cash holding. By the confirmation of previous research, board size, board independence and CEO duality, has been taken as predict variables, firm size as control variables to test the influence of CG on cash holding; empirical evidence shortened below to backing research issue above.

Harford at el (2008) examine the relationship between CG and cash holding from US companies and proposed week CG results in low cash holding. Additionally, in Canada, Gill and Shah (2012) argue that cash could be used to reduce the pressure on managers to perform efficiently and could be used by managers to invest in projects that serve their own benefits. Thus, larger board size may allow managers to hold spare cash in the firm. However, Drobetz and Grüninger (2007) find no link between board size and cash holdings. The large boards are supported on the basis that they could offer improved monitoring and advice (Anderson, Sattar & Reeb, 2004; Coles, Daniel & Naveen, 2008). Chaganti, Mahajan and Sharma (1985) find that non-bankrupt firms have larger boards compared to bankrupt firms, suggesting that large boards assist in firm survival.

Walsh and Seward (1990) suggest that board independence might be doing an effective job to monitor and control management, which helps to improve firm value and mitigate agency problems. the review of literature on the relationship between board independence and cash holdings and the results are mixed. In the US, Chen (2008) find that board independence has a positive relationship for the new economy companies and negative relationship for the old economy companies. Kusnadi (2011) finds board independence positively and significantly influences cash holdings. He argues that firm with less board

**Frame work of the study**



independence would be more susceptible to agency problems, thus, hold larger amount of cash. Chen and Wang (2014) find that board independence is related to lower cash holdings.

Jensen (1993) states that it is important to separate the positions of chairman from CEO if the board is to function as an effective monitoring device. Mallette and Fowler (1992) state that agency theory indicates if the chairman of the board is the CEO, it reduces the effectiveness of board monitoring.

Drobetz and Grüninger (2007) suggest that agency issues are increases when chairman as well as CEO is the same person. So, the researchers found a positive link between CEO duality and cash holdings. Canada, Gill and Shah (2012) also find cash holdings are positively and significantly related to CEO duality. Further Lee and Lee (2008) find that the CEO and chairman have separate positions which leads to lesser cash holdings signifying that separating the positions of CEO and chairman reduce the propensity to hold extra cash. Lastly, Ozkan and Ozkan (2004) and Chen and Wang (2014) find that cash holdings are not link to CEO duality.

The firm size is the important aspect that uses adverse influence on cash holding since companies are need to grasp smaller quantity of cash due to economies of scale, (Bates, et al., 2009). Larger companies are stickers who have much achievement in the business that's why they advantage from superior inner sources. Through the indication of this larger companies can accumulate much cash. According to Opler, et, al (1999) found and indicate small companies accumulate big amounts of cash. On the other side, few other researchers proposed that there was no significantly linked firm size with cash holding (Guney et al., (2007):Ozkan, and Ozkan, (2004); Khan & Ali ,(2017). So, the advantages of having big amount of cash balance might be support to finance the capital investment plans and it is less expensive than the outdoor funds ( Kusnadi, 2003).





Corporate governance mechanism has been taken by BOS, BOI, and CEO\_D, firm size has been taken as control variables. Subsequent hypotheses have been expressed to achieve the research objective:

H1: B\_SIZE has a positive significant influence on companies' cash holdings

H2: B\_IND has a positive significant influence on companies' cash holdings

H3: CEO\_D has a positive significant influence on companies' cash holdings

### Research methodology

To test the influence of CG on cash holding is the main aim of present study. To complete this research, the Jordanian manufacturing companies that are part of the Amman Stock Exchange (ASE) were considered for exiting study, as a sample. Due to lack of data or inadequate data essential to conduct this particular research, 26 companies out of 68 companies. The data was collected thorough financial statement of the companies' annual reports. The data was collected from year,2008 to 2012. Accordingly, the panel data of 26 manufacturing companies for five years led to 130 observations.

**Table I; Measurement of the variables**

| Variables          | Measurement   |
|--------------------|---|
| Cash Holding       | Cash and cash equivalents / Total Assets (Opler, et, al, 1999)                            |
| Board Size         | No, of inside and outside directors on board (Khan & Ali, 2018)                           |
| Board Independence | No, of independent directors / Board of directors (khan & Ali, 2017)                      |
| CEO Duality        | Coded "1" if chairman also holds the position of CEO and "0" otherwise ( Khan & Ali 2017) |
| Firm Size          | Log of total assets (Khan & Ali, 2017)  |

### Model Estimation and Specification

$$CH_{it} = \beta_0 + \beta_1 BOS_{it} + \beta_2 BOI_{it} + \beta_3 CEO\_D_{it} + \beta_4 FS_{it} + \epsilon_{it} \dots \dots \text{model (1)}$$

Where as

CH<sub>it</sub>: Cash Holdings, BOS<sub>it</sub>: Board Size, BOI<sub>it</sub>: Board Independence, CEO\_D<sub>it</sub>: CEO Duality,FS<sub>it</sub>: Firm Size

### Data Analysis

#### Descriptive Analysis

Descriptive statistics of the variables comprised in the existing study have been given in the Table II below.

**Table; II**

| Variables | Obser | Mean   | Std.Devi | Mini  | Maxi   |
|-----------|-------|--------|----------|-------|--------|
| CH        | 130   | .0642  | .1096    | .0002 | .60378 |
| BOS       | 130   | 7.622  | 1.932    | 1.00  | 13     |
| BOI       | 130   | 7.7461 | 1.9302   | 0.000 | 1.000  |
| CEO_D     | 130   | .0856  | .2894    | 0.000 | 1.0000 |
| FS        | 130   | 9.415  | .4663    | 7.767 | 10.311 |

The table II, he Person descriptive statistics of dependent and predicted variables used in this current study are represented in Table II; which shows that cash holding average is 0.0642 with the minimum value is 0.0002 and the maximum value is 0. 60378.The average value of the board size is 7.622 with the minimum value 01 and maximum 13. The board independence average value is 7.746 and CEO duality average is .085. the average value of firm size is 9.415

**Table III; Relationship between corporate governance and cash holding**

| Variables      | B-value | T-value | P-value |
|----------------|---------|---------|---------|
| CH             |         |         | .       |
| BOS            | 0.1635  | 2.82    | 0.004   |
| BOI            | 0.1342  | 2.07    | 0.039   |
| CEO_D          | 1.10    | 5.06    | 0.000   |
| FS             | 3.67    | 5.15    | 0.000   |
| _cons          | -70.45  |         |         |
| R <sup>2</sup> | 0.015   |         |         |
| P-value        | 0.000   |         |         |

The above table III, shows the value of ( $R$ )<sup>2</sup> is 0.15 percent which indicate the variation of the model. Moreover, indicates the results of board size has a positive significant relationship with cash holding and supported with hypothesis H1. This result in line with previous studies who found the positive significant link between board size and cash holding (Gill and Shah 2012; Kusnadi 2011; Lee and Lee 2009). In addition, the results also indicate the positive significant relationship between board independence and cash holding and hypothesis H2 is accepted. These results are in line the previous studies who found the positive significant relationship between board independence and cash holding (Chen and Wang 2014; Kusnadi 2011; Lee and Lee 2009). Similarly, the CEO duality have positive significant relationship between with cash holding and H3 is supported this results in line with previous studies (Gill and Shah 2012; Drobetz and Grüniger 2007). Firm size is also positive significant and this results align with the previous studies (Khan and Ali, 2017; Khan and Ali, 2018).

### Conclusion

The current study provides the results the how corporate governance and cash holding are related. The relationship was tested empirically particularly in the perspective of Jordanian manufacturing companies which are publically quoted. Based on the empirical results of the current study, it can be concluded the board size, board independence and CEO duality had a significant relation with cash holding of manufacturing listed companies. These empirical results of study might be beneficial for the policy makers and practitioners to consider the CG mechanism to keep the optimal cash holding in company.

The main restriction was the time period to get the data from the whole listed companies in Jordan. Moreover, good results may be gained by considering whole companies with long time period. The examination on three variables that relate to CG was done in this study. Further research could include some other important factors, such as female directors, remuneration and audit committees.

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