

GOVERNMENT-LINKED BANKS' PERFORMANCE IN JORDAN

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Abstract

The main objective of this study is to examine the relationship between government ownership and bank performance in Jordan. The banking sector has been widely ignored in the past corporate governance studies due to its strict system. Using a panel data from 2004 to 2013 (147 observations/years), the multiple regression analysis shows that increasing the percentage of shareholdings leads to higher profitability. Additional government-linked banks (GLBs) generally outperform their unlinked counterparts. However, their outperformance is contingent to the significance percentage of the shareholdings. On other words, if the government shareholdings are not significant (less than 10%) the government ownership does not make a significant difference in the performance. Using panel data provide us with a significant roles played by the period of the study. The banks show increasing in their performance through the period of this study. However, the size and the age of the banks are found to be insignificant while the leveraged banks significantly underperform their counterparts. The results of this study might be of interest of potential investors, policy makers, governance agencies and information users.

Keywords: Government-Linked Banks, Government Ownership, ROA, Panel Data, Jordan

JEL Classification: G32, G34, G 21

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1. INTRODUCTION

Profitable firms are more attractive for investors. Previous studies consider the financial profitability and stability as fundamental factors prior to invest in any firms (Mallin, 2007; Khan, Nemati & Iftikhar, 2011). As a result of the collapse of the big banks worldwide and locally, the investor has lost their confidence in the markets. Therefore, government ownership seems to play significant roles in attracting foreign and local investors. Presence of government ownership may give the investors more confidence in the government-linked banks (GLBs). Zeitun and Gang Tian (2007) reported that the government ownership play significant roles in reducing the probability of firm default and playing social objectives rather than economic objectives.

Government ownership is considered as a significant factor in the recent studies conducted in the East Asian countries where the government ownership is relatively high such as in China (Lau, Lu & Liang 2014), Malaysia (Mohd Ghazali, 2007; Abdullah, Mohamad & Mokhtar 2011; Ahmed Haji, 2013; Fauzi & Musallam, 2015; Musallam, 2015) and Singapore (Eng & Mak, 2003; Ang & Ding, 2006). In some countries, the states might own the firms and accordingly control them such as in China. Thus, the largest companies are either to be linked to the government or to be owned and controlled by the state. However, less attention is paid to the government ownership in the Arabic region including Jordan. Large companies in the Middle East and North Africa (MENA) are usually unlisted. They are either state-owned or family-owned firms (Omet, 2005). In addition, the state-owned companies are oil or energy companies (Omet, 2005).

In Jordan, the government ownership seems to be insignificant. ASE (2009) reported that the government ownership in the listed firms is less than six percent. Interestingly, Omet (2005) reported that there are only three firms, out of the largest 20 firms in Jordan are not listed and they are owned either by families or by the state. Very few studies have investigated the government ownership in the Jordanian market due its insignificant level.

The objectives of government-linked companies (GLCs) differ from private-owned companies' objectives (Shepherd, 1989; Estrin & Perotin, 1991; Claessens & Fan, 2002; Zeitun & Gang Tian, 2007; Musallam, 2015). Shepherd (1989) argues that government implements its political objectives such as employment through its linked companies. According to Estrin and Perotin (1991) government-owned companies has political and economic objectives, thus, maximizing the firm performance is not the sole objective of the GLCs. However, GLCs may focus on promoting social targets and developing the economy at a country level rather than a company level or political supports (Boycko, Shleifer, & Vishny, 1996; Shleifer & Vishny, 1997; Shen & Lin, 2009). According to Eng and Mak (2003), GLCs may go beyond pure profit objectives and consider objectives related to the interests of the whole nation.

Therefore, the differences in the objectives between the GLCs and private-owned companies may increase the agency costs (Xu & Wang, 1999; Eng & Mak, 2003), weaken the investors' protection (Shepherd, 1989; Shleifer, & Vishny, 1997) and weaken the governance system (Estrin & Perotin, 1991). In addition, the goals of the GLCs may be conflicted with economic objectives of the firms (Mak & Li, 2001). Eng and Mak (2003) pointed out

that GLCs may not consider the maximization of the shareholders' value as a primary objective. Thus, governments might use their firms to implement the social and political goals regardless of the short term profits. However, Eng and Mak (2003) argued that GLCs have better financial and funding resources compared to non-GLCs in Singapore. In addition, GLCs' managers are less likely to face discipline from the market community in issues related to the corporate control because it is expected that the government is long-term investors (Eng & Mak, 2003). Further, it is expected that the government-linked banks (GLBs) might outperform their counterparts.

The rest of the paper is organized as follows; the next section provides a general discussion of the Jordanian banks. Section three presents the hypothesis development. Research methodology is presented in the fourth section following with the data analysis in the fifth section. Finally the conclusion and future works is discussed.

2. BANKS IN JORDAN

The Jordanian Banking Act (2000) is issued to organize the banking sector in the country. The banking sector in Jordan, similar to other countries, is considered as a vital sector. The bank should be listed unless it is a branch of a foreign bank or affiliated to a listed institution or offshore company (Article 6). The bank Act (2000), considers the bank as an affiliated if 50% or more of its shareholdings is owned by another individual or group of individuals who have the same interests (Article 1). Moreover, Jordanian Companies Act (22/1997) and its revision (22/2006), defines the offshore companies as the companies that are registered in the country and operating outside the country. In Jordan, they are 16 operating local banks; 15 are listed banks and one is an affiliated to another Jordanian listed bank. However, the foreign branches are not included in this study due to the focus on the local banks only.

Largest companies in the Middle East are either family-owned or state-owned. In other words, the total number of large listed companies in the Middle East is very small. According to Omet (2005), the largest 20 firms in such Middle East countries are not listed. The case of Jordan is very unique in the region. That is, out of the top largest 20 firms, 17 firms are listed (Omet, 2005). In comparison to the neighboring countries, there are only three firms, two firms and one firm listed in Kuwait, Saudi Arabia and Oman respectively. The three unlisted Jordanian firms are either owned by families (private individuals) or state-owned such as Royal Jordanian.

Thus, the government ownership in the listed firms is not significant. The government ownership was almost 15% before the privatization process begun in the country in 1998. Recently, based on the ASE's data (2009) the government owned almost five percent. The government owns companies in the mining sector such as Jordan Phosphate Mines, the Arab Potash, Jordan Petroleum Refinery companies and Jordan Cement Factories. In addition, the state owns the Royal Jordanian and appoints its board of directors. However, no previous study has examined the government ownership in the Jordanian banking sector.

Banking sector in Jordan is considered as the leading sector in the market. Based on the statistical published data by the CBJ, the banking sector occupies approximately 44% of the total market capitalization in the country in 2012. Furthermore, the banking sector contributes to the Jordanian JDP by almost 51%. More interestingly, the banks' total assets represent 80% of the total assets in the market in 2012. In addition, 14 listed banks out of 16 are amongst the largest 20 listed firms in the market indicating that the banking sector is the largest sector in Jordan.

3. HYPOTHESIS DEVELOPMENT

3.1. Government Ownership and Bank Performance

The phenomenon of GLCs is common in the Asian region. In Singapore for example, the government owns more than 75% of some companies (Eng & Mak, 2003). In Malaysia, the Government-Linked Investment Companies (GLICs) are described as "companies that have primarily commercial objectives and in which the federal regime of Malaysia has a straight controlling stakes to at least appoint board members" (Musallam, 2015). Due to their significant controlling ownership, the Malaysian government has the power to appoint the directors in the boards, top managements either directly or through GLICs (Amran & Devi, 2008; Esa & Mohd Ghazali, 2012). GLICs play very significant roles in structuring the economy in Malaysia (Musallam, 2015).

Further, it is expected that the information asymmetry is less likely to be problematic in GLBs because those companies have a unique channel of information and they might need to publish their information to the public to signal the government's transparency. Thus, corporate transparency and government ownership might be associated. Moreover, GLBs are trusted by the public. GLCs are less likely to face the default in Jordan (Zeitun & Gang Tian, 2007) which might be easily generalized to GLBs.

Empirically, very limited studies have focused on the impact of the government ownership on the performance (Fauzi & Musallam, 2015). Further, the majority of the existed studies have been done in the markets with high level of government ownership such as in Malaysia (Fauzi & Musallam, 2015; Musallam, 2015) Singapore (Eng & Mak, 2003; Ang & Ding, 2006) and China (Sun, WHS Tong & Tong, 2002). Widely, the banking sector is obviously ignored in the previous studies. Furthermore, the Arabic markets seem to have different ownership structure. Although the state-owned companies in the Arabic countries are the largest in size but they are not listed. Very few large firms are listed in Oman, Saudi Arabia, Qatar, Morocco and Lebanon (Omet, 2005).

In Malaysia, the government ownership is found to significantly enhance the firm performance. Thus, government ownership is seen as a vital mechanism in aligning the firms' activities to obtain higher level of performance (Lau & Tong, 2008; Sulong & Mat Nor, 2010). Furthermore, Ghazali (2010) found that the firms with substantial government ownership outperform their counterparts. Fauzi and Musallam (2015) used panel

data from 190 listed firms in the Malaysian market during the period of 2000 to 2009 to examine the performance of GLICs. Their findings suggest that GLICs ownership improves company performance. In Jordan, the government ownership is found to be negatively associated to firm performance measured by ROE (Zeitun & Gang Tian, 2007). However, the authors argued that the government may not focus mainly on the profit maximization. Thus, the authors suggest the government ownership to decrease the probability of default.

However, the case of Jordan is unique in this context; even the largest companies are publically listed. From the largest 20 firms in Jordan, there are 17 listed firms (Omet, 2005). The other three firms are either state-owned firms such as Royal Jordanian, or family-owned firms. In addition, in the banking sector, there is no any privatized bank. All the banks are established as individual businesses. However, the government, through its Security Social Corporation, may invest in any listed firms. The Security Social Corporation tends to invest in the listed firms for a long term; it may hold the shares in specific firms for very long period. Yet, the Jordanian government owns less than six percent of the total listed firms' shares.

Thus, due to the insignificant percentage of the shares held by the government, the roles of the government might be different. In addition, the government ownership may play security investment roles in the market. Government ownership decreases the probability of firm default in Jordan and they have social objectives rather than economic objectives (Zeitun & Gang Tian, 2007). Thus, the following general hypothesis is stated:

H_1 : increasing the percentage of government shareholdings significantly enhances the bank performance (ROA) in Jordan.

4. METHODOLOGY

4.1. Data

The data of this study includes all the 16 local banks operating in Jordan; 15 banks are publically listed and one bank is 100% owned by another bank (affiliated bank). Out of the 16 banks, there are three banks are operating based on the Islam rules (Islamic banks). Interestingly, it is important to notice that the conventional banks are not allowed to open an Islamic window in Jordan. On other words, the bank is either to be Islamic or conventional but not mixture. In this study, the banks' annual reports, and banks' corporate governance reports are the main source to gather the data. The annual reports are downloaded from either the banks' websites or form ASE (<http://www.ase.com.jo/>). In the case of unpublished annual reports, they are collected manually from the banks. In general, out of 155 annual reports, the study could collect 147 annual reports; 122 annual reports were downloaded online while 25 annual reports were collected manually from the banks. However, eight annual reports were missing. The procedures of data collections are summarized in Table 1.

Table 1. Summary of the sample

Expected Sample	160 (16 banks*10 years)
Non-operating period	(5) (1 bank*5 years)
Possible sample size	155 banks
Missing data	(7)
Final sample size	147 banks/year
Online-downloaded annual reports	122 annual reports
Hand-collected annual reports	25 annual reports
Total collected annual reports	147 annual reports

The data is collected from the Jordanian banks in a period of 10 years (2004-2013). The year of 2013 is chosen because it is the most recent year when conducting this study. However, in the year of 2003, three of the Jordanian banks faced some financial troubles. As a result, two of those banks merged with other banks, and one bank restructured its activities, management and board. Therefore, two of those three banks are not existed anymore. Thus, the year of 2004 is chosen. In the other words, all the banks in this sample have been working during the period of this study except Jordan-Dudi Islamic bank which is listed in the year 2009.

4.2. Research Approach

Secondary sources are used to gather the data for this research, mainly firms' annual reports. In collecting the data, this study uses secondary sources. Secondary data includes both qualitative and quantitative, and can be used for both descriptive and explanatory studies (Kervin, 1999). As well as, it is considered as an interpretation of primary data (Cooper & Schindler, 2003). Secondary data is referred to the data that already exist such as annual reports, published statistics, books and internal reports kept by the firms (Veal, 2005). In regard to government ownership, data is collected from the shareholding statistics. Furthermore, the data related to the control variables; bank size, bank age and leverage, is collected from the banks' profiles and banks' financial performance reports. Lastly, data on ROA is extracted from annual reports, more specifically from the financial statement.

4.3. Pearson Correlation

Pearson correlation is used for two main purposes (Weisberg, 2005); firstly to check the correlation between the dependent variable and independent variables in one hand, and between the dependent variables to each other on the other hand and secondly, to check for multicollinearity. The government ownership and ROA are found to be insignificantly correlated while a positive significant correlation is found between ROA and all control variables at one percent. In addition, government ownership is found to be positively correlated with all the control variables at significant level. Further, bank age is found to have positive and significant correlations with bank size and leverage at one percent as presented in Table 2.

Table 2. Pearson correlation Matrix

		1	2	3	4	5	VIF	1/VIF
1.	ROA	1.000						
2.	Government Ownership	0.113	1.000				1.18	0.85
3.	Leverage	0.306**	0.214**	1.000			1.34	0.75
4.	Bank Size (log)	0.223**	0.302**	0.108	1.000		2.87	0.35
5.	Bank Age	0.225**	0.187*	0.367**	0.762**	1.000	3.05	0.33

Note: ** and * is significant at 1% and 5% respectively.

Focusing on the multicollinearity, the multicollinearity is said to be problematic if two independent variables are highly correlated. Even the cut-off point is debatable between the statisticians, but the majority of the authors consider the multicollinearity as a problem if the correlation between two independent variables reaches to 0.80 (Gujarati, 2003). Thus, the Pearson correlation matrix indicates that the model of this study is free of multicollinearity problem. The highest correlation between two independent variables is found between bank age and bank size at 0.76.

In alternatives multicollinearity tests, this study uses variance inflation factor (VIF) and tolerance variance inflation (1/VIF). The multicollinearity is considered as a problem if the VIF is more than 10.00 (Hair et al., 2006) or if 1/VIF is less than 0.10 (Pallant, 2011). The results of this study indicates that neither VIF nor 1/VIF present multicollinearity problem as shown in Table 2.

5. DATA ANALYSIS

5.1. Descriptive statistics

As shown in Table 3, relatively low of profitability is found in this study. In average, the ROA is two percent. The best performing bank recorded a profit of six percent while the worst performing bank record a loss of two percent. The lost is recorded in the Jordanian banks by only two banks, one of them recorded lost due to corruption of one of its employees as reported in their annual report. Regarding the government ownership, the government owns almost seven percent of the banks' shares with a maximum of 25%. Interestingly, it is noted that there is no bank controlled by the government. However, some banks have no shares held by the government. Moreover, the government owns insignificant percentage of some banks' shares (less than 10%).

Table 3. Descriptive Analysis

	ROA	GOVOWN	BSIZ	BAGE	LEV
Mean	0.02	0.07	21.	31.6	0.76
Median	0.02	0.04	30	20.9	0.85
SD	0.01	.08	17.9	1.05	0.22
Max	.06	0.25	24.3	1	0.96
Min	-.02	0	19	83	0.19
Skewness	.451	0.84	1.258	.91	-1.82
Kurtosis	5.33	2.34	5.176	3.66	4.68
Obs	147	147	147	147	147

5.2. Panel Data Analysis

Prior to regress the model, the data is checked for normality. Normality is "degree to which the distribution of the sample data corresponds to a normal distribution" (Hair et al., 2010). Several tests can be employed to check the normality distribution of the data. The most common normality tests are skewness and kurtosis. Kline (1998) recommended the data to be normally distributed if the skewness and kurtosis are between ± 3 and ± 10 respectively. All the variables of this study fill in the range of Kline as shown in Table 3.

We test for heteroscedasticity using Modified Wald test as suggested by Greene, (2000). A written command (xttest3) is provided in STATA. In addition, we test for autocorrelation using Wooldridge test (xtserial). The results indicate that the data of this study is heteroscedastic and autocorrelated. Thus, we use Drisc/Kraay standard errors (xtscc) to solve the both problems as suggested by (Driscoll & Kraay, 1998). The xtscc command is suitable for both balanced and unbalanced panel data. In addition, it handles missing values.

In this study, Multiple Linear Regressions (MLR) is utilized to test the direct relationships between the independent and dependent variables using STATA version 10. Different tests are applied to determine the best model of this study. Firstly, F-test is carried out to compare between fixed-effect model and pooled OLS. Significant F-test result (P-value > 0.05) indicates acceptance of the fixed effect model and vice versa otherwise. Then, Hausman test is applied to choose between the fixed-effect and random-effect (Greene, 2011). The null hypothesis postulates that the unique errors are not correlated with the regressors. Thus, significant P-value (Prob>Chi² is less than 0.05) indicates that the null hypothesis is rejected and the hypothesis is accepted and vice versa. The proposed model is given as:

$$\text{PROFT}_{it} = \alpha_0 + \beta_1 \text{GOVOWN}_{it} + \beta_2 \text{BSIZ}_{it} + \beta_3 \text{BAGE}_{it} + \beta_4 \text{LEV}_{it} + \varepsilon_{it} \quad (1)$$

where:

- PROFT: is the bank profitability, which is the bank financial performance, measured by the return on assets (ROA) which is earnings before tax divided by total assets. Similar

measurement was used in the previous studies (e.g. Ghabayen, 2012; Al-Matari et al., 2012; Saibaba & Ansari, 2013).

- GOVOWN: is the government ownership measured as the percentage of the shareholdings held by the governments (The Security Social Corporation).
- LEV: is leverage and it is the ratio of the book value of long-term debt divided by total assets (Anderson & Reeb, 2003; Alsaeed, 2006; Al Matari et al., 2013; Amran & Che-Ahmad, 2013).
- LOGSIZ: is the natural log of the total assets. This measurement is widely used in the previous studies (e.g. Liu, Ahlstrom & Yeh, 2006; Amran & Che-Ahmad, 2013; Ibrahim & Samad, 2013; El-Chaarani, 2013).
- BAGE: is the bank age measured as the number of years since the bank started incorporated similar to some other studies (e.g., Shumway, 2001; Ghabayen, Mohamad & Ahmad, 2016).
- it: period indicator
- ϵ : Error Term.

In panel data, if the Hausman specification tests recommend the use of fixed effect, the data needs to be checked for the using of the year as a control variable. In STATA (version 10), a written command (testparm i.year) is used to check the significant level of the effect of the time period as suggested by (Torres-Reyna, 2007). Significant

p-value indicates that the coefficients for all years are jointly not equal to zero. Therefore the data is needed to be controlled by the time period in this case (Torres-Reyna, 2007). In this study, the effect of the time period is very significant. The R^2 was 11.36% and it increased to 41.7% after controlling the data with time period (as shown in the first model in Table 4). This indicates that the performance of the Jordanian banks is getting better throughout the period of this study.

The main results are presented in the first model (Table 4). The government ownership is found to have significant and positive effects on the banks' performance. Similar results were found previously (e.g. Lau & Tong, 2008; Ghazali, 2010; Sulong & Mat Nor, 2010; Fauzi & Musallam, 2015). In general, the results of this study suggest that increasing the percentage of shares held by the government leads to increase the profitability. It is noted that the government might hold insignificant (less than 10%) percentage of the shares in a specific bank. But, however, wherever the government has shares, they will have a representative director to represent them in the board. Therefore, this raises the question of either the government plays the same roles regardless of the percentage of shares or the roles of the shareholders (government) is linked to the size of shareholdings.

Table 4. Multivariate Analysis

Variables	Model (1)		Model (2)		Model (3)	
	Coef	t	Coef	t	Coef	t
Constant	.0064	0.00	.0235	0.59	.0122	0.29
Government Ownership	.0925	4.87**	.0019	1.63	.0105	2.25*
Leverage	-.0659	-2.94**	-.0669	-2.76*	-.0592	-3.13**
Bank Size (log)	.0029	1.36	.0021	0.93	.0022	0.91
Bank Age	.0001	0.94	.0001	0.69	.0001	0.72
Years	Included		Included		Included	
Observations	147		147		147	
Modified Wald test	0.000		0.0000		0.0000	
Wooldridge test	0.0182		0.0234		0.0136	
Prob > F	0.0000		0.0000		0.0000	
Hausman Test	0.0000		0.0000		0.0000	
R ² (within)	0.417		0.404		0.424	

Note: ** and * is the significance level at 1% and 5% respectively.

Government ownership is measured as percentage of the shares held by the government in the first model, by the presence of the government ownership in the second model and by the presence of the government as blockholder (10% or more of the shareholdings) in the third model.

Thus, two alternative measurements are used to examine the relationship between government ownership and the bank performance. The first measurement is based on the presence of government ownership in the banks while the second measurement is based on the presence of the government as a substantial shareholder (owns 10% or more of the shares). Descriptively, the government has shares in 56.6% of the banks. Further, the government is a substantial shareholder in almost 30.6% of the banks as shown in Table 5. This result indicates the low level of government ownership in Jordan. Mohd Ghazali (2007) reported that government is a substantial shareholder in 64% of the largest 87 firms listed in Malaysia.

The empirical result of the second measurement is presented in the second model.

Presence of government ownership (regardless of the percentage of shareholdings) has no significant effects on bank performance.

Table 5. Descriptive of Government Ownership

	Presence of Government ownership	Presence of government blockholders
No. of observation	83	45
percentage	56.6%	30.6%

However, if the government is a substantial shareholder, the banks will significantly outperform their counterparts. This indicates that the roles played by the government are contingent to the percentage of shareholdings. It is unarguable that the percentage of ownership and voting power are related. Thus, the possible justification of these results may come from the institutional theory. As the Security Social Corporation in Jordan is the government's investment arm in the country, more

conflicts may occur in the banks with insignificant shares owned by the governments especially if we consider that the government has a representative director(s) in all the government-linked banks regardless of the proportion of the shares. Thus, we suggest that different institutional objectives may increase the conflicts in the board.

The banks with a government blockholder may get some financial facilitates from the government. Banks in Jordan rely on the low-cost deposits. Thus, the government may be one of the biggest customers in their connected banks because there is no governmental bank in Jordan. Thus, depositing the government's money in specific banks increases the solvency of the banks. Further, government-linked banks may benefit from the low-cost debt as well. As the government may launch some initiatives to support some projects (such as projects targeted SMEs) with low interest rate, the government-linked banks are more probable to get those funding projects. In addition, the government-linked banks may have substantial resources to the information via their boards.

6. CONCLUSION

The government ownership is the main focus of this paper. Very few studies have linked the government ownership to the firm performance in the Arabic region while the banking sector is widely ignored in the majority of the previous studies. This paper is one of the few papers that focus on the roles of the government ownership on the performance of banks. Interesting results are found in this paper. Increasing the percentage of government ownership enhances the profitability of the banks. However, being linked to the government does not necessarily enhance the performance. The empirical results show that the presence of the government as a shareholder does not have significant effects on performance. However, it is found that the presence of the government as a blockholder (with 10% or more of the shareholdings) enhances the profitability of the banks. The study uses the leverage, bank size and bank age to control the models. In the three models, only the leverage is found to be significant while bank size and bank age are found to be insignificantly related to ROA. The main implication of this study is that the government ownership should be considered as one of the important ownership structure in the MENA. This study found that the percentage of government ownership is not significant but still can play significant role in improving the profitability in the banks. Thus, future works may investigate to which level the government ownership may enhance the performance. In addition, as the ownership structure significantly effects to the board structure, the characteristics of the government-linked banks and the board mechanisms in the government-linked banks may be of interests of the future works.

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