Under COVID-19 Pandemic Impact: Do Internal Mechanisms Play Fundamental Role in Corporations’ Outcomes?

http://doi.org/10.21272/bel.6(1).83-91.2022

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Abstract

The new coronavirus (COVID-19) epidemic has had a significant impact on health care, the economy, transportation, and other areas in several businesses and locations worldwide. As a result of the quarantine policy, population mobility fell drastically, resulting in diminished people's spending power and ultimately a stagnating economy. The same is true in The Hashemite Kingdom of Jordan, where the government has imposed a severe countrywide lockdown and a nocturnal curfew since the commencement of the COVID-19 epidemic. All travel to and from the country was halted as the borders were closed. In addition, many local and national preventative and control efforts have been undertaken to contain the spread of COVID-19 throughout the country. The present work aims at estimating the impact of internal mechanisms on corporations' outcomes under the COVID-19 pandemic. The current work uses statistical analysis via SPSS, a Statistical Software, to test the hypotheses based on data collection of 100 corporations belonging to industrial and service corporations from the Hashemite Kingdom of Jordan’s financial market for 2020. Regression analysis is used to test the hypotheses of the current work that are represented by board size, independent non-executive managers, and financial leverage of corporations, considering testing the control variable as well, representing the industrial type. Financial leverage is the dependent variable of the present study. The findings revealed that the greater number of independent non-executive managers, the big board size leads to a negative impact of financial leverage. The results showed that independent non-executive managers do not affect financial leverage. Furthermore, the findings admit that the industry type has no impact on financial leverage. The practical implication of the current work is helpful for different parties like academics and scholars in the Hashemite Kingdom of Jordan context. The present work adds contribution to the poor literature via introducing empirical evidence regarding the financial leverage as an indicator to the corporation's outcomes - corporation performance and internal mechanisms relationship under the impact of COVID-19 pandemic.

Keywords: COVID-19, Internal Mechanisms, Corporations’ Outcomes, Hashemite Kingdom of Jordan.

JEL Classification: G3, F5.


Received: 14 February 2022 Accepted: 21 March 2022 Published: 29 March 2022

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Introduction

The storm of the COVID-19 Pandemic has quickly spread all over the countries around the world. It continues to appear unstoppable with negative effects on all economies around the world, especially the non-financial corporations industrial and service ones. Wrongly, many people believe that the Corona pandemic has caused health problems only, it, in fact has become a danger to the economy, society, and transportation and imposes the need for distancing between people. Furthermore, many companies have been closed and affected the stock market in both developed and developing economies. Although some industries in the early months of the outbreak of the Coronavirus pandemic experienced great demand, such as groceries,
some industries faced big collapses, e.g., airlines. All these factors led to a major economic recession worldwide, which cost trillions of dollars. Therefore, it was necessary to have a state of development and flexibility in technology and politics and the flexibility to stand against the effects of Coronavirus. With the existence of several harmful elements, there is a lack of work on the impact of internal mechanisms on firm features like financial leverage as an indicator of the firm performance under the effect of Coronavirus. In that, very poor studies were found to test the effect of financial leverage on corporations' outcomes (strong financial performance) under the impact of COVID-19.

There is a growing desire at both local and international levels for states to adopt the best practices in internal mechanisms (IM) for businesses to place themselves to be successful properly and addresses the issues posed by the international economy. Jordan is one of the countries that has emphasized best practices to tackle the problems of economic growth. IM is a collection of ideas expressed by principles and procedures. The system can be exact if these concepts are gathered and organized logically following the business setting. The result of its implementations can be favourable for a firm if every stage is followed and adhered to appropriately. It can increase the value of all important stakeholders, such as employees, investors, consumers, and other related stakeholders. IMs that are solid and best practices should strongly characterize a corporation’s strategic decision-making. Proper IM and decision-making processes that are effective may positively impact financial factors, for instance, the external financing method. As a result, measures including the board of directors (BOD) size as well as the number of non-executive managers selected to the board may lead to an impact on the financial leverage (FL) decisions taken.

Certainly, the concept that debt can be regarded as a necessary instrument for managers and corporation’s FL is crucial to the accounting, finance, and management literature; they must guarantee that their corporation’s resources are not squandered. Managers who choose well-designed IM can best situate themselves regarding their corporation’s debt structure, reducing agency issues that may arise due to a possible conflict among shareholders and managers. As a result, based on past research, organizations that adopt and adhere to excellent IM are expected to have lower FL levels or lower debt levels. According to a survey of the literature, the issue of FL remains an important topic in economics, finance, and accounting and has sparked a huge amount of research. According to the literature review, various hypotheses have been proposed to demonstrate and better comprehend a corporation’s financial leverage. The agency hypothesis, which explains the formation of FL through agency costs as a result of a dispute between the stakeholder parties of stockholders and managers, has received widespread acceptance.

IM is crucial in balancing the relationship between shareholders and a corporation's management level to minimize agency issues. As a result, a company that implements best-in-class internal control procedures should face fewer conflicts of interest. FL has also been used as a strategy to reduce agency costs and adopt and adhere to best-practice IM. FL can help agencies with a variety of issues. Allowing directors to get more stocks in a firm is one strategy to reduce agency problems and the conflicts that go with them (Al-Najjar, 2010). A rise in debt financing leads is linked to an increase in the managers' shares. Using FL, nevertheless, can result in bankruptcy in the worst-case situation. According to the agency theory, a corporation's top management team may not drive to maintain a good level of FL. As a result, the shareholders' wealth may be underutilized.

Higher degrees of financial leverage, as indicated in earlier studies, can have a detrimental impact on the strength of the system of IM, which can lead to agency issues when IM should be designed to minimize rather than enhance agency conflicts. As a result, they reasoned those significant levels of FL above an appropriate level could impair IM, leading to increasing levels of agency conflict. FL has been determined as a component of risk and financial leverage in prior investigations in the literature review. Moreover, in the study of IM, another body of research looked at FL as a crucial signal of financial leverage. Jordan has had severe hurdles and economic problems due to several causes, including regional instability, reliance on grants and remittances from Gulf nations, natural resource pressures, and high unemployment. As a result, as Alabdullah (2019) noted, these obstacles have produced significant issues for the Jordan economy in general as well as the corporations listed on the ASE.

**Literature Review**

Several works have tested the control mechanisms and their impact on profitability, performance, and value of the firm (Amidu, 2007; Almashhadani & Almashhadani, 2022; Alabdallah et al., 2021; Ahmed et al., 2019; Alabdullah, 2017; Abor, 2007; Kanaan-Jebna et al., 2022; Alabdullah, 2017; Alabdullah et al., 2021; Ahmed et al., 2020; Al-Najjar, 2010; Alabdullah et al., 2018; Abushammala et al., 2015; Ahmed et al., 2014;
Ahmed et al., 2019; Ahmed et al., 2014; Ahmed et al., 2021; Arping & Sautner, 2010; Alabdullah, 2016a; Alabdullah & Ahmed, 2020; Ahmed et al., 2017; Ahmed et al., 2021; Ahmed et al., 2018; Alabdullah, 2016a,b,c,d; Barakat & Saif, 2010; Alfadhel & Alabdallah, 2016; Alabdullah, 2019; Ahmed, 2014; Alabdullah et al., 2014; Alabdullah, 2018; Almashhadani, 2020; Al-Akra, M. & Hutchinson, 2012; Alabdullah et al., 2018; Ahmed et al., 2016; Alabdullah, 2021a; Almashhadani, 2021; Al-Husan & James, 2012; Hull et al., 2011; Almashhadani & Almashhadani, 2022; Alabdullah et al., 2018; Alfadhl & Alabdullah, 2013).

The firm’s top position is the board of directors (BOD), which oversees the company and its activities. The BOD holds an essential task in strategic decisions in financial structure. According to the findings in the literature study, there is a mixed link between FL and board size. Companies with a big board size have low financial leverage, according to Alabdullah et al. (2021). They emphasized that managers pursue lower gearing levels to improve corporate success in the long run. In a similar vein, Abor and Biekpe (2007), with support of Ahmed et al. (2020) investigated the relationship between the financial leverage of SMEs in Ghana and IM. They discovered a negative relationship involving financial leverage and board size, with larger boards having lower FL levels in general. Other research looked at the link between financial leverage in corporations and foreign ownership and discovered a negative correlation. Others looked at the relationship between IM-FL and discovered a negative correlation between leverage and managerial ownership. The bigger the FL, the less equity the company employs, and the higher the risk of agency conflict. Others, on the contrary, investigated the relationship between IM, as depicted by particular board composition, and FL, as depicted by Chinese publicly traded companies FL. They discovered a link between FL and board size. A study conducted by Alabdullah et al., (2018) indicated a negative association involving financial leverage and board size, according to the literature review on the depiction above and others in developing nations and more recently in Jordan. As a result, in forecasting a hypothesis involving FL and board size, the present research anticipates that adding the managers’ quantity selected to the BOD, which is increasing board size, should be related to lower FL. The subsequent hypothesis is based on the debate above:

**H1: There is a negative link between board size and a corporation’s financial leverage**

Furthermore, modern IM is built on the foundation of non-executive directors on boards (independent boards). A few studies have looked into the relationship between financial leverage and the presence of non-executive directors, but the outcomes vary. Non-executive directors have a critical role in a corporation’s ability to attract attention from external stakeholders, according to Alabdullah (2019). It reduces the corporation’s risk and improves its capacity to raise cash. They claim that having a larger number of non-executive directors on BOD results in an increased FL. Others have discovered that companies with greater gearing levels possess more non-executive directors and vice versa. Moreover, in a similar line, Ahmed found that in Ghanaian SMEs, organizations with more non-executive managers have a greater gearing level. Furthermore, prior research, such as Al-Husan & James (2009) and Jackling, B., & Johl, S. (2009), have shown that non-executive directors on boards have a detrimental link with gearing levels. The most likely reason is that managers are almost obliged to pursue lower gearing levels to improve performance since an independent board (non-executive directors) supervises them more effectively. IM are designed to improve a corporation’s performance. As a result, the present research hypothesized that:

**H2: There is a negative link between independent board and financial leverage**

The present research is cross-sectional that uses two statistical methods to examine all its hypotheses: SPSS was used to test 100 accessible sample data of Jordanian non-financial corporations (industrial and service corporations). The hypothesis on the effect of board size and independence on financial leverage was tested using multiple regression analytic instruments, with industry type effect as a control variable. In addition, the data for this study came from the Amman Stock Exchange's (ASE) annual reports for the year 2020. I gathered accounting data for independent, dependent, as well as control variables to help the current study achieve its goal.

**Methodology**

The present study is the first to look at the link involving dependent and independent variables in a Jordanian setting while controlling for industry type. Financial leverage was used to determine the dependent variables in this study. Board size and independent board are two IM. Furthermore, the type of industry is a control variable. The measurement of the study’s variables represented by the dependent variable is financial leverage that could be measured as debt in total divided by capital. As for the independent variables, board size is measured as the number of managers appointed to the board of directors. Independent managers that
are non-executive is measured as the number of outside directors appointed to the board. While the measurement of the industry type, which is the control variable, is dummy, one of the companies belongs to the service sector and zero if it is not. Based on the aim of the present work and the explanation in the literature, the assessment of the current study’s model is:

\[ FL = \alpha_0 + B_1BD + B_2IND + B_3indust + \varepsilon \]  

\( (1) \)

**Results and Arguments**

**Descriptive Analysis.** The present study results showed that Skewness and Kurtosis values revealed a sample in distributed data, which means there is no normality problem since the values of Kurtosis and Skewness are within the accepted range. Also, the standard Skewness is between +1.96 to -1.96, and furthermore, the standard Kurtosis is between +3 and -3. The descriptive analysis shows that financial leverage (FL) has a Mean of .723, standard deviation .344, Minimum value .300, Maximum value 1.196, Skewness value 1.415, and Kurtosis 2.606. The descriptive analysis shows that board size (BD) has a Mean of 8.98, standard deviation .071, Minimum value 5, Maximum value 15, Skewness value .291, and Kurtosis -1.042. The descriptive analysis shows that independent directors (IND) have a Mean of 0.354, standard deviation 0.329, Minimum value .000, Maximum value .934, Skewness value -.391, and Kurtosis -1.353. The descriptive analysis shows that Industry type (IND) has a Mean of 0.441, standard deviation .488, Minimum value .000, Maximum value 1.0, Skewness value .246, and Kurtosis -1.981.

**Correlation Test.** The correlation reveals that there is no multicollinearity which means there is no problem between independent variables which is here less than 0.80 as explained in Table 1, below:

\[ FV = \alpha_0 + B_1BD + B_2IND + B_3indust + \varepsilon \]  

\( (2) \)

The authors ran regression analysis between all the variables and the findings revealed that the Standardized Coefficients of board size is significantly and negatively linked to financial leverage with value of BD; \( \beta = -0.420 \) and t-value is -4.388. It reveals also that IND has a positive but insignificant link with FL in value of IND; \( \beta = 0.004 \) and t-value is 0.035. Likewise, the control variable which is industry kind has no impact on financial leverage with value of \( \beta = 0.020 \) with t-value of 0.197.

<table>
<thead>
<tr>
<th>Study’s Variables</th>
<th>FL St. Coef.</th>
<th>BD St. Coef.</th>
<th>IND St. Coef.</th>
</tr>
</thead>
<tbody>
<tr>
<td>BD</td>
<td>-0.420**</td>
<td>-4.388</td>
<td>0.000</td>
</tr>
<tr>
<td>IND</td>
<td>0.004</td>
<td>0.035</td>
<td>0.973</td>
</tr>
<tr>
<td>Industry</td>
<td>0.020</td>
<td>0.197</td>
<td>0.845</td>
</tr>
</tbody>
</table>

Source: Compiled by the authors

The current work can deduct significant and negative links between BD and FL. Such finding is compatible with previous works that were done previously (Godfrey et al., 2009; Alabdullah, 2016; Berger et al., 1997; Abor & Biekpe, 2007; Alabdullah, 2019). Therefore, H1: A negative link between the board of directors’ size and a firm’s financial leverage is supported. These findings believe that the more BD in non-financial firms in the Jordanian context, the less FL. FL necessity is to be one, while it is .723; that means it is less than one. Regarding the problem of the present work concerning the unwell economy in Jordan, it reveals a cash deficit. It can be justified that the cash by firms in Jordan relies on internal cash. Accordingly, the firms must borrow money from creditors to get the cash and then use it in the investments. Regarding the link between
independence of the board of directors (IND) and financial leverage (FL), the present study tested its hypotheses and revealed that there is no impact (insignificant) link between IND and FL at p. <1, t-value= 0.035. It reveals that there is no significant link between firms that have more numbers of non-executive directors and FL. It is incompatible with hypothesis H2: There is a negative link between the independent board and financial leverage. Thus, H2 is not supported. The findings are in line with previous works of the previous studies.

**Conclusion**

Under the unbelievable issue of COVID_19 Pandemic, this work aims to look into the influence of board size and independent board on corporations’ outcomes represented by financial leverage of Jordanian listed businesses utilizing cross-section data from a sample of 100 corporations listed non-financial companies obtained from the Amman Stock Exchange's website in Jordan. FL is employed to illustrate capital structure in connection to board size and independence as two effective internal control in the current search. This research adds to the previous studies done in the Middle East, notably in the Jordanian context. Prior research has dealt with such variables, considering the significant challenges in non-financial enterprises and the Jordanian economy in general. Following tests, the current research discovered the subsequent challenges: The size of the BOD has a negative and significant association with FL.

On the contrary, there is no link involving an independent board of directors and FL, and the same can be said for industry type, which has no bearing on FL. Furthermore, the model of the relationship involving FL and board composition discovered in this study is significant. In light of real and significant concerns, the current research is novel in the Jordanian setting to bring new awareness to the link within these variables. Finally, future research in developing nations should examine investigating the association involving these variables (FL and board composition) in determining the conclusions from various perspectives and development levels in both non-financial and financial organizations.

**Author Contributions:** Conceptualisation: Tariq Tawfeeq Yousif Alabdullah and Muath Asmar; methodology: Tariq Tawfeeq Yousif Alabdullah and Muath Asmar; project administration: Tariq Tawfeeq Yousif Alabdullah and Muath Asmar; investigation: Tariq Tawfeeq Yousif Alabdullah and Muath Asmar; data curation: Tariq Tawfeeq Yousif Alabdullah and Muath Asmar; formal analysis: Tariq Tawfeeq Yousif Alabdullah and Muath Asmar; validation: Tariq Tawfeeq Yousif Alabdullah and Muath Asmar; visualization: Tariq Tawfeeq Yousif Alabdullah and Muath Asmar; writing-original draft preparation: Tariq Tawfeeq Yousif Alabdullah and Muath Asmar; writing - review & editing: Tariq Tawfeeq Yousif Alabdullah and Muath Asmar.

**Funding.** There is no funding for this research.

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