

Corporate Governance, Ownership Structure and Bank Performance in Jordan

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Abstract

This study set out with the aim of investigating the effect of ownership structure and corporate governance on bank performance (profitability and operating efficiency). The study relied much on publicly available data for a sample of the thirteen listed banks in Jordan for the years 2000 to 2012. The study has shown that ownership concentration has a positive and significant effect of bank performance (profitability) while foreign ownership positively affects the bank performance (operating efficiency). Another important finding is that as board size increases the bank performance (profitability) increase, suggesting that good corporate governance standards are imperative to every bank and important to investors and other stakeholders.

Keywords: bank performance, bank profitability, bank operating efficiency, corporate governance, ownership structure, Jordan

1. Introduction

Corporate governance concerned with the processes and structures that direct and manage the institutions affairs in order to improve long term shareholders' value by enhancing corporate performance and accountability, taking into account the interest of other stakeholders (Jenkinson & Mayer, 1992). Corporate governance is needed because of the existence of agency problems caused by the separation of ownership of resources and managing those resources (Jensen & Meckling, 1976). Good Corporate Governance practice is one mechanism used to minimize the conflict of interest between agents (management) and principals (shareholders). Since the bank sector is the most important sector in any economy, it is critical for economic growth and development; hence, there is a need for its strict regulation all over the world and Jordan is not an exception of that.

Studies have shown that ownership matters in bank performance, foreign-owned banks tend to be more efficient and less risky than domestic banks (Bongini et al., 2001, 2002; Gupta, 2004; Sturm & Williams, 2004), also privately-owned banks have superior performance than to state-owned banks (barth et al., 2000; La Porta et al., 2002; Cornett et al., 2000; Lang & So, 2002; Ghazali, 2010).

It is believed that, the major contributor to banking crisis is weak corporate governance practice (Asian financial crisis, Asian Development Bank, 2000). Therefore, it is important to investigate the influence of corporate governance practice on bank performance.

In Jordan, there is little research effort devoted to investigating the effect of corporate governance on bank performance, as most empirical studies exclude financial firms from their sample. So, this study prepared as a contribution to the work of corporate governance investigations in developing countries by examining the association between corporate governance, ownership structure and bank performance in a Jordan. The paper addresses two key research questions:

Q1. What is the effect of ownership structure on bank performance in Jordan?

Q2. What is the effect of corporate governance on bank performance in Jordan?

The rest of the paper is organized as follows: section 2 considers the literature review and hypotheses development. Section 3 describes data and methodology. Section 4 describes the empirical results and section 5 concludes the paper.

2. Literature Review, Motivation of the Study and Hypothese Development

2.1 Literature Review

In the context of banking, corporate governance has been defined as the manner in which bank systems, procedures, processes and practices were managed. In addition, assets and resources should be managed with an aim of increasing shareholder value and shareholder satisfaction together with improved accountability, resource use and transparent administration.

Jensen and Meckling investigate the theoretical relationship between corporate governance and firm performance for the first time in 1976. They developed the theory of ownership structure of the firm by bringing together elements from three main theories: the theory of agency, theory of property cost and theory of finance. They found the fact that as the manager's ownership claim decreases his incentive to give effort to maximize the firm's value decreases and so the agency cost will increase which leads to a decrease in firm's net value.

Following Jensen and Meckling (1976) findings, many researchers looked at the impact of ownership structure. Eldenburg et al. (2004) hypothesized that board' objectives and governance will differ across ownership types. They test the effect of the board's decision to replace the CEO and the extent to which this decision differs across different ownership types. They found that the variation in the composition of the board of directors leads to differences in both the determinants of board of director's turnover, and the determinants of CEO turnover. Staikouras et al. (2007) reported that there is a statistically significant and negative relationship between return on assets (ROA) and return on equity (ROE) and the board size. Alonso and Gonzalez (2006) document a positive relation between the proportion of non-executive directors and performance. Zulkafli and Samad (2007) analyzed the corporate governance of listed banking firms in nine Asian emerging markets. They suggested that there are differences in the monitoring mechanisms of banking firms and non-bank. Accordingly they classified corporate governance mechanism that serves to monitor the banking firms into first, ownership monitoring mechanism (large shareholders, government ownership, and foreign ownership). Second, internal control monitoring mechanism (CEO duality, Board size, board independence). Third, regulatory monitoring mechanism and fourth, disclosure monitoring mechanism. The researchers in this study assumed a direct relationship between corporate governance monitoring mechanism and corporate performance of banking firms that measured by (Tobin's Q ratio and ROA), using a regression model. The findings show that bank performance measures are significantly negatively related with all ownership monitoring mechanism, positively related with both regulatory monitoring mechanism disclosure monitoring mechanism, and that there is no significant relationship between performance and the internal control monitoring mechanism. Spong and Sullivan (2007) investigate the different aspects of corporate governance that influence bank performance using a random sample of state-chartered community banks. They found that an ownership stake for hired managers could help improve bank performance, consistent with a reduction in principal-agent problems posited by financial theory. They also found that when directors have a significant financial interest in the bank, boards of directors would have a more positive effect on community bank performance.

2.2 Motivation of the Study

Recently, Jordan has taken series of legislative, economic and financial reforms that intended to promote transparency, accountability and the rule of law in the economic life of the country. Managerial inefficiency and accounting scandals alert the legislators, government and management of banks and big corporations to the danger involved in the absence of constraints governing corporate governance. The lake of constraints were viewed as being conducive to definite losses by the shareholders and those who hold interests in these enter parties, to destabilize the national economy and investment climate. All of that have reinforced interest in consolidating the foundation and principles of corporate governance in the Jordanian economy.

The Jordanian experience, even though it has been a short one, has demonstrated that business communities passed various stages towards adopting effective corporate governance practices, the Corporate Compliance Authority plays an important role by enforcing many basic corporate governance provisions of the Company Law. Another key player in enhancing corporate governance is the Central Bank of Jordan. Further to issuing the bank Director's Handbook of Corporate Governance in 2004, the Central Bank of Jordan is continuing its efforts to enhance corporate governance in the Jordanian banking system by preparing the Corporate Governance Code, which is intended to promote international best practice in the corporate governance of Jordanian banks.

The aim of this paper is to examine the relationship between ownership structure, corporate governance and bank performance in a developing country such Jordan.

2.3 Hypotheses Development

2.3.1 Ownership Structure

In this paper, we represent the ownership structure by ownership concentration, institution ownership and foreign ownership.

2.3.2 Ownership Concentration

Empirical evidence on the association between ownership concentration and bank performance is mixed. Some of previous studies have reported a positive relationship between ownership concentration and corporate performance (Perrini et al., 2008; Gedajlovic & Shapiro, 2002; Al-Farooque et al., 2010; Ma et al., 2010; Silva & Majluf, 2008; Garcí'a-Meca & Sa'nchez-Ballesta, 2011). Their findings were supported by the efficient monitoring hypothesis (EMH), which argue that greater ownership concentration can eliminate the agency conflict between owners and management and decrease the costs of management monitoring and leads to improved performance and productivity. Conversely, other researchers have shown that there is a negative relationship between ownership concentration and corporate performance (Boone et al., 2011; Jiang et al., 2009; Mudambi & Nicosia, 1998). In the same vein, some studies have shown that there is no relationship between ownership concentration and performance (McConnell & Servaes, 1990; Prowse, 1992; Iannotta et al., 2007).

In our study, we expect a positive association between ownership concentration and bank performance:

H1: there is a positive relationship between ownership concentration and bank performance.

2.3.3 Institutional Ownership

Obviously, institutional investors choose good project to invest their money in looking for more returns and profitability. Furthermore, they play an essential role in corporate governance by imposing greater monitoring of the managers' performance or by taking control of the companies' affair. As a result, the conflict of interest and agency problem will be reduced (Al-Najjar, 2010; Maug, 1998, Huddart, 1993).

In addition, institutional investors play a significant role in reducing external monitoring cost by transferring more information about the company to other shareholders. Moreover, they have much influence on the decisions concerning their large investment in companies (Brickley et al., 1988). The efficient monitoring hypothesis (EMH) argues that institutional shareholders can monitor of the management more efficiently than the individual shareholder can, also they can reduce the agency cost more efficiently. Considering the (EMH), a positive relationship between institutional ownership and performance is expected (McConnell & Servaes, 1990; Shleifer & Vishny, 1997; Smith, 1996; Filatotchev et al., 2005). Conversely, a negative relationship between institutional ownership and performance was advocated depending on conflict of interest and strategic alignment hypotheses, (Barnhart & Rosenstein, 1998). In addition, Cronqvist and Nilsson (2003) and Craswell et al. (1997) conclude that there is no significant relationship between institutional ownership and performance. Considering the literature, we can formulate the following hypothesis:

H2: There is a positive relationship between institutional ownership and bank performance.

2.3.4 Foreign Ownership

Along with ownership structure, ownership nationality—that is, domestic or international ownership—is another factor that can lead to differences in organizational objectives, practices, and governance mechanisms (Eldenburg et al. 2004; Kangis & Kareklis, 2001). If foreign investors hold a large portion of shares of a corporation, a signal will be sent to all other participant in the market that foreign investors have a high confidence in these companies. Accordingly, the value of the company will increase. Bai et al. (2004) reported a positive effect of foreign investor's holdings on market valuation of a company. In the same vein, foreign shareholding may increase the company value by disclosing more information in their annual reports (Haniffa & Cooke, 2002). The findings indicate that disclosing more information could attract more investors (local and foreign), so we can expect that companies with a higher proportion of foreign shareholders perform better than others perform:

H3: There is a positive relationship between foreign ownership and bank performance.

2.3.5 Corporate Governance

Academics and practitioners have long recognized that the primary functions of the board of directors are two-fold: monitoring and advising top management (Jensen, 1993). Nevertheless, discussions of corporate governance often equate board effectiveness with monitoring effectiveness in our study we present the corporate governance by Board size and CEO duality.

2.3.6 Board Size

Board size is mostly used as an indication of both monitoring and advisory role (Klein, 1998), so it plays an important role in company success and growth. The primary responsibility of the board of directors is to protect the shareholders' assets and ensure they receive a decent return on their investment. Effective board should satisfy two main functions, the first one is the advisory function by consulting with management regarding the strategic and operational direction of the company. The second one is the oversight function by monitoring the senior management, company performance and reducing the agency cost. One question that needs to be asked, is there an ideal or optimal board size? The empirical results on optimal board size are mixed. According to Adams and Mehran (2003), when there is a large number of a member in the boardroom, there will be enough people to monitor the management more easily and effectively. In addition, large number of boards may reflect more variety in experience. While Lipton and Lorsch (1992) asserts that large board size are less effective compared to small boards because there is a tendency to form cliques and core groups, thus deteriorating overall cohesion. On the other hand, small board size might not effectively monitor powerful managers.

In our study, we expect to see a positive relationship between board size and financial performance, assuming that a greater number of director increases the potential to establish useful contacts with the environment, and industry-specific expertise that benefits the firm.

H4: There is a positive relationship between Board size and bank performance.

2.3.7 CEO Duality

Generally, the CEO communicates the board on behalf of the management and communicates the shareholders, employee and other stakeholders on behalf of the company. His main responsibility is to manage the firm's day-to-day activity and business; whereas, the chairman has the responsibility to ensure that the board as a whole plays a full and constructive part in the development and determination of the company's strategies and policies, and that board decisions taken are in the company's best interests and fairly reflect board's consensus. In particular, CEO duality refers to a situation where a CEO also acts as a chairman of the board or a member of the board that governs the corporation.

Boyd (1995) asserts that duality provide more power to CEO if he acts as a chairman of the board. According to the agency theory perspective, when a board chairman is also a CEO will gain sufficient controlling power to gain more private benefits. Therefore, company can reduce the conflict of interests between shareholders and management by separating the tasks of decision management and decision control.

According to Ehikioya and Benjami (2009), firms in which CEO and Chairman of the board are separated stakeholders are likely to gain confidence on the firms' ability to raise additional capital and hence there are less chances of bankruptcy of the firm. However, Some Researchers agreed that there is no single optimal leadership structure because both duality and separation perspectives have related costs and benefits. Thus, duality will be beneficial for some firms while separation is likely be valuable for others (Brickley et al., 1997).

H5: There is a positive relationship between CEO Duality and bank performance.

3. Data and Methodology

The study investigates the performance of the banks over the period 2000-2012 using data mainly from banks' annual reports and financial statements for the various years.

3.1 Data, Variables, and Descriptive Statistics

The number of operating banks in Jordan at the end of 2012 stood at 26 banks, of which three are Islamic banks and ten are branches of foreign banks, including a branch of an Islamic bank. These banks carried out their operations through a network of 714 branches and 84 representative offices all over the Kingdom (Note 1). The Jordanian banking sector is highly regulated and the central bank keep all the required information about the 26 banks but this information is not available for public. To overcome data availability problem we select only banks listed at Amman Stock Exchange (ASE) so we can get the required data from the published financial statements. There is a fifteen banks listed at ASE two of them were Islamic Banks. After excluding the Islamic Banks, thirteen publicly listed Jordanian banks will be included in our sample. The study covers the period from 2000 to 2012. The necessary annual data on corporate governance, ownership structure and bank performance were collected from the annual report issued by each bank.

Bank performance as a dependent variable may presented by profitability and efficiency figures. This study used two measures of performance as dependent variables i.e. **Return on Assets (ROA)** ratio and the **Operating Efficiency Ratio**. ROA reflects the deployment of bank assets to yield its income (Adams & Mehran, 2003;

Andres & Vallelado, 2008; Weisbach, 1988; Kobeissi, 2004; Zulkafli & Samad, 2007). It is calculated by dividing the net income (including provision for credit loss) by the total Assets it is calculated by dividing the net income (including provision for credit loss) by the total Assets. On the other hand, the operation efficiency ratio (calculated by dividing the total operating expenses (including provision for credit loss) by total operating revenues) indicates an expense control problem; it is a traditional measure for bank productivity. At its simplest, it is the cost required to generate each dollar of revenue.

The explanatory variables include **Ownership Concentration (OC)**: to measure ownership structure by considering the holdings of the largest shareholder; which is simply the ownership concentration ratio. **Institutional Ownership (INST)**: The ownership of institution was measured by the ratio of institution stockholdings. **Foreign Ownership (FORS)** was measured by the ratio of foreign stockholdings. **Board Size (BSize)**: calculated by simply counting the number of individuals serving on the board of each bank. **CEO Duality (DU)**: to consider the effect of duality-leadership structure on bank performance and uncover how this concentration of power is associated with it, we employ a dummy variable. We use DU as a variable name to represent duality; it is assigned a value of 1 if a bank's general manager is also the chairman of the board and 0 otherwise.

In addition to these corporate governance variables and ownership structure variables, our model includes standard control variables for other bank's attributes that may affect the performance. Control variables include the bank's size and riskiness. The size of the bank is presented by logarithm of total assets. Bank riskiness is the potential risk associated with the bank and measured by the ratio of total loan loss provisions to total assets, (Kobeissi, 2004). Definitions of these variables listed in Table 1. We adopt definitions used by previous studies to make a meaningful comparison with their empirical results. Our data mainly comes from the annual reports, so all variables are measured using book values.

Table 1. Variable definition

Variable	Definition
Dependent Variables	
ROA	Bank performance measured by: Net income / Total assets
Operating Efficiency Ratio	Bank performance measured by: total operating expenses (including provision for credit loss) / total operating revenues)
Explanatory Variables	
Ownership Concentration (%)	Proportion of shares held by large shareholders.
Institutional ownership	Proportion of shares held by institutions.
Foreign Ownership (%)	Proportion of shares held by foreign shareholders
Board Size	Number of members in the boardroom.
CEO Duality	1: if Chairman=CEO 0: if Chairman ≠ CEO
Control Variables	
Bank Size	Logarithm of total assets.
Bank Risk level.	total loan loss provisions to total assets

3.2 Methodology

Our sample includes data across banks and over time, so we employed a panel data regression model that can be specified as follows:

$$Performance_{i,t} = \alpha_1 + Corporate \cdot Governance \cdot i,t + X_{i,t} + \varepsilon_{it} \quad (1)$$

$$Performance_{i,t} = \alpha_1 + Ownership.Structur \cdot i,t + X_{i,t} + \varepsilon_{it} \quad (2)$$

Where i represent the cross-section dimension and t indicates the time dimension, X it is a vector of explanatory variables (e.g., Risk_{i,t}, Size_{i,t} for the Ith Bank.)

4. Empirical Results

The descriptive statistics of all variables (dependent, explanatory and control variables) are presented in Table 2. In particular, the average profitability Ratio (ROA) and Operating Efficiency Ratio for the sample of banks is 1.2 and 1.7 respectively. On average, the Jordanian banks have 10 members on their board, with high ownership

concentration (56.76%). Approximately, in 47 percent of the observations the CEO was serving as the chair of the board.

Table 2. Descriptive statistics for dependent, explanatory and control variables

	Mean	Max.	Min.	Std. Dev.
Dependent Variables				
ROA	1.228414	4.965200	-5.475100	1.016762
Operating Efficiency Ratio	1.731214	6.540400	0.132700	0.751978
Explanatory Variables				
Ownership Concentration (%)	56.76	89.06	11.5	20.59
Institutional ownership	40.75	93.28	1.07	24.26
Foreign Ownership (%)	5.97	36.72	0.000	7.52
Board Size	10	13	4	2
CEO Duality	1: if Chairman=CEO 80 obs. (47%) 0: if Chairman # CEO 89 obs. (53%)			
Control Variables				
Bank Size (in millions JD)	2,571	23,921	53.4	5,057
Bank Risk level.	0.08983	0.903852	0.003997	0.101602
No. of observation	169			

Table 2 presents a general picture of the Jordanian banks included in our sample. Concerning the performance measures, the average ROA was low (1.2%) and the average value for operating efficiency was 1.7 indicating that most of the Jordanian banks have a high operating expense. On average, Institutions hold 40.75 percent of total outstanding shares of Jordanian Banks (individuals hold more than 50% indicating that the majority of listed banks were in family hands), while shares held by the foreign investors' amounts to 5.97 percent and range between 0 and 36.72 percent suggesting that not all banks in the analysis had a foreign investment.

We apply panel data regression (random effect model) to test the effect of ownership structure on bank performance; the estimation results of regression for the first three hypotheses are presented in Table 3. Panel A shows that coefficient of ownership concentration was statistically significant and positively related to the ROA ratio, suggesting that block shareholders have more ability than dispersed shareholders to force the management to work for benefit of the shareholders. In addition, a high ownership concentration among Jordanian banks is shown in Table 2 indicating that, on average five individuals hold a significant (56.76 percent) proportion of total shares issued by the banks. Therefore, the ownership concentration is one of the most important factors to be considered when evaluating the performance of banks in Jordan.

Table 3. Regression result for testing the effect of ownership structure on performance

Panel A. Performance measured by profitability ROA

	H1	H2	H3
Ownership Concentration	0.025980*	-	-
Institutional Ownership	-	0.000732	-
Foreign Ownership	-	-	0.0000465
Size	-0.259637***	-0.046416***	-0.049104***
Risk	-0.291428	-0.844841**	-0.918283**
ROA(-1)	0.461727*	0.482051*	0.481064
C	4.650314	1.717547	1.810492
R-squared	0.413480	0.333138	0.332850
Adjusted R-squared	0.345967	0.315472	0.315177
F-statistic	6.124447*	18.85838*	18.83398*

Panel B. Performance measured by operating efficiency ratio

	H1	H2	H3
Ownership Concentration	0.000526	-	-
Institutional Ownership	-	-0.000913	-
Foreign Ownership	-	-	0.006630***
Size	-0.042390**	-0.048373**	-0.048592*
Risk	-0.839141*	-0.940149*	-0.790837**
Efficiency(-1)	0.508168*	0.509667*	0.507910*
C	1.809754*	2.007934*	1.925426*
R-squared	0.326745	0.327327	0.330567
Adjusted R-squared	0.308911	0.309507	0.312833
F-statistic	18.32090*	18.36936*	18.64098*

Note. * Value is significant at 1%. ** Value is significant at 5%. *** Value is significant at 10%.

The institutional and foreign ownership coefficients were positive but not significant; these results could be partially because banking sector in Jordan is essentially built upon family businesses. Regression results in Panel B shows that the foreign ownership has a positive and significant effect ($t=1.4$, $p=0.1$) on bank operating efficiency indicating that foreign ownership brings more efficiency to bank operating and minimizing the total operating expenses.

The two control variables included in the analysis were statistically significant. However, contrary to expectation, larger banks were found to be less profitable and efficient perhaps due to problems in coordinating the different functions or line of businesses.

The regression results for testing the effect of corporate governance on bank performance shown in table 4. Panel-A presents the effect of corporate governance factors on bank profitability. The board size coefficient was positive and significant which is consistent with the conclusions drawn by Zahra and Pearce (1989) who argued that a large board size brings more management skills and makes it difficult for the CEO to manipulate the board. The CEO duality is positively related to the profitability of the bank but the relationship is statistically insignificant. The positive relationship indicates that when CEO also serves as chairman in the board, the bank still have a high profitability level measured by ROA. In general, the profitability of banks measured by ROA is high in banks where CEO faces a strong monitoring. Panel-B presents the effect of corporate governance on bank operating efficiency. The coefficients of board size and CEO duality were positive but not significant indicating that the corporate governance factors did not affect the Jordanian bank performance. This finding was unexpected and suggests that that the sizes of the sample of the two groups (CEO duality) are very close to each other. Table (2) shows that the number of observations when there is no separation between chairman and CEO group is (80), while the number of observations in the separation group is (89).

Table 4. Regression result for testing the effect of corporate governance on performance

Panel A. Performance measured by profitability ROA

	H4	H5
Board Size	0.261554***	-
CEO Duality	-	0.040279
Size	-0.229438**	-0.047747***
Risk	-0.035628*	-0.937812*
ROA(-1)	0.457747*	0.482515*
C	2.751109	1.764062
R-squared	0.413170	0.333255
Adjusted R-squared	0.345621	0.315593
F-statistic	6.116613*	18.86839*

Panel B. Performance measured by operating efficiency ratio

	H4	H5
Board Size	0.007563	-
CEO Duality	-	0.107017
Size	-0.048778**	-0.041653***
Risk	-0.835512*	-0.934743*
Efficiency(-1)	0.509617*	0.509833*
C	1.890340*	1.781222*
R-squared	0.326848	0.331405
Adjusted R-squared	0.309016	0.313694
F-statistic	18.32947*	18.71169*

Note. * Value is significant at 1%. ** Value is significant at 5%. *** Value is significant at 10%.

However, the statistics in respect of CEO duality is quite alarming considering about 47 percent of sample banks did not separate between Chairman and CEO. This means that the listing requirement regarding CEO duality was not met by some sample banks investigated.

5. Conclusion

This paper set out to determine the impact of corporate governance and ownership structure on bank performance using panel data regression. The study has shown that ownership concentration variable possesses positive and significant value; thus, one can say that ownership concentration do matter as far as bank performance is concerned, which suggests that principal–principal conflict may be deeply entrenched in the Jordanian banking sector. On the other hand, the institutional ownership and foreign ownership do not affect the bank performance as expected. This finding could be partially due to the specific characteristics of the banks in our sample that represent the listed banks on Amman Stock Exchange (ASE) only.

Concerning the corporate governance factors, our results support the resource dependence theory, which suggests larger board size would lead to better corporate performance using ROA because of the different skills, knowledge, and expertise brought into boardroom discussion. Our duality variable, which we use to evaluate the concentration of power in one individual, also did not approach significant values. We can conclude that the duality of CEOs is not important among Jordanian banks, and as only around half of banks use this structure, it is not common as well. However, if real power lies with the dominant shareholders (i.e., the founding families), the presence or absence of duality is really a moot point.

It is suggested that the association of these factors is investigated in future studies by considering all the working banks in Jordan including the foreign banks.

Finally, there are a number of policy implications related to our study. Our results suggest that ownership concentration is important in the significance of bank performance. Policymakers should emphasize ownership concentration when they consider policy decisions on issues related to bank performance. Although the results are not significant for board size and duality, we maintain that these governance mechanisms should not be overlooked, as previous studies find significant roles for these variables. Although, for many reasons, concentrated ownership is generally not preferred, our findings support the use of concentrated ownership, as it reduces the negative implications of tenure on bank performance. Accordingly, we suggest the reconsideration and careful analysis of the pros and cons of ownership structure in an emerging market. Our results also suggest that, in mergers and acquisitions, policymakers should again prioritize ownership type, as it plays a role in bank performance through the size effect.

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Note

Note 1. Source: central Bank of Jordan Annual report (2012).

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