

**BOARD CHARACTERISTICS AND FIRM PERFORMANCE AMONG KUWAITI  
COMPANIES**

By

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COMPANIES**

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## **ABSTRACT**

The issue revolving around corporate governance has always been an essential and critical element for both private and public sectors particularly in Kuwait. Kuwait's Prime Minister has even stressed for more concentration on the issues of governance for the purpose of overseeing the effective running of the public and private sector through a check and balance system. Moreover, the Prime Minister argued the need of the firms in the country to benchmark to an effective system that emphasizes on positive issues such as ethics, openness, accountability, transparency, and integrity in the public and private sector. Therefore, this crucial issue has to be addressed accordingly in order to enhance the performance of firms.

It has been generally believed that good corporate governance is a critical factor in the improvement of firm value in both developing and developed financial markets. However, this belief overlooked the fact that the relationship between corporate governance and the value of a firm varies in developing and developed financial markets owing to the character of the corporate governance structures existing in the markets based on dissimilar social, economic and regulatory conditions. This reality calls for the need to examine and comprehend the differences affecting the firm value for the purpose of academic, financial and management practices and public regulation of markets and corporations.

The core aim of the present study is the examination of the relationship between board characteristics and firm performance of non-financial, listed Kuwaiti firms on the Kuwaiti stock exchange. For the purpose of the study, data was collected from a sample of 136 companies for the financial year of 2009. Among corporate governance's various variables, five were chosen to be included in the study namely CEO duality, COE tenure, audit

committee size, board size and board composition and one measures namely return on assets (ROA) was chosen as measures of firm performance.

Furthermore, regression analysis was utilized for the examination of the relationship between board characteristics and firm performance. The result indicates that the relationship between CEO duality and ROA is positive in the significant level. Therefore, this result found that the relationship between CEO tenure and ROA is negative in the significant level. By contrast, this result found that the relationship between audit committee size with ROA is positive with significant level. In addition to that, this result found that the relationship between board size and board composition is negative but not significant. Furthermore, this study using firm size and leverage as a control variables found that the relationship between firm size and ROA is positively insignificant. Finally, the outcome of the relationship between leverage and ROA is negatively significant.

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## LIST OF ABBREVIATIONS

Abbreviation	Description of Abbreviation
OECD	Organization for Economic Cooperation and Development
BOD	Board of Directors
CEO	Chief Executive Officer
GDP	Gross Domestic Product
ROA	Return on Asset
EAT	Earnings After Tax
ROE	Return on Earnings
RI	Residual Income
PM	Profit Margin
ROI	Return on Investment
OCF	Operating Cash Flow
EVA	Economic Value Added
MENA	Middle East and North Africa
GCC	Gulf Cooperation Council
CLSA	Credit Lyonnais Securities Asia
OLS	Ordinary Least Squares
NED	Non -Executive Directors
FIRMPFC	Firm Performance
$\alpha_0$	Constant
CEODUATY	CEO Duality



CEOTENUR	CEO Tenure
AUDITSIZ	Audit Committee Size
BOADSIZE	Board Size
BOADCOM	Board Composition
FIRMSIZE	Firm Size
LEVERAGE	Leverage
MCCG	Malaysian Climate Change Group

## **CHAPTER ONE**

### **INTRODUCTION**

#### **1.1 Background of Study**

Businesses around the world require development and growth in order to attract funding from investors. Before they invest in a particular business, investors normally make sure that the business in question is financially secure and stable and possesses the ability to produce profits in the long run (Mallin, 2007). Hence, in instances where the company position is not as promising, it will not be as attractive to investors as it hopes to be. This failure to attract enough capital normally leads to negative consequences for the business in particular and for the economy in general.

Based on the agency theory, the agency relationship is a contract whereby one or more persons (principal) engage another person (agent) to perform some service on their behalf, which involves delegating some decision-making authority to the agent (Jensen & Meckling, 1976). Nevertheless, the theory also holds the notion of the inappropriateness of management or the agent in taking the best possible action for the public and for the shareholders' sake as the agents generally acts for their own interests. Therefore, for the achievement of a balanced alignment between the principal's and agent's interests, and to remain within the agency budget, different internal as well as external corporate governance mechanisms have been expounded on (Haniffa & Hudaib, 2006).

Governments all over the globe, takes recourse in corporate governance for the safety and security of the business environment. According to the Organization for Economic Cooperation and Development (OECD), it has been stated that "good corporate governance is

essential for the economic growth led by the private sector and for the promotion of the social welfare". In retrospect, since 1997, the Asian financial crisis has brought about a whole new meaning to corporate governance as evidenced from the crisis of confidence in the institutions and legislation that make up the governance of business and interactions between business and government.

In addition, corporate governance is considered as a necessity for the facilitation of a modern economic expansion and development. Many theorists of corporate governance have inspected the link that exists between corporate governance and the overall company well-being. Also, evidence in studies has highlighted corporate governance's influence upon firm performance. Among these studies is one carried out by Brown and Caylor (2004) that displayed a positive link between corporate governance and performance, particularly when regarding factors such as board composition, and board committee members. It has been generally accepted that the main function of the board of directors is to oversee the various performance measure of the organization. In other words, the CEO as well as the board members should come up with effective decisions that work for the best interest of the organization as a whole. The board most crucial role is to oversee the long as well as the short term objective and strategies of the company.

In similar lines, corporate governance has been considered as a set of measures or procedures that manipulates the organization for maximum achievement of goals and long-term fulfillment of shareholders' benefits. Therefore, effective corporate governance is crucial in protecting the interests of shareholders and is equally crucial in protecting the interests of customers, suppliers, employees and in facilitating the government's efforts in guaranteeing the accountability of firms (Vinten, 1998).

The measures employed by corporate governance can be categorized into internal and external disciplining measures. The former includes board of directors, large and institutional shareholders, insider ownership, compensation packages, debt policy, and dividend policy while the latter includes takeover threats, product market competition, managerial labour market and mutual monitoring by managers, security analysts, the legal environment, and the role of reputation (Farinha, 2003).

Based on a study by Klapper and Love (2004) firms employing effective governance display less necessity of the legal system for resolution of conflicts. The authors also state that firms can employ measures to counteract ineffective laws through corporate governance, and they can provide investors with the necessary protection which leads to the improvement of their performance and valuation. On the other hand, Claessens (2003) who has reviewed extensively on corporate governance came up with the identification of various channels through which corporate governance influence the economic performance of firms, markets and economies as a whole. The first channel involves the firm's increasing access to external financing, which may lead to greater investment, higher growth and effective employment creation. The second channel involves minimizing the cost of capital and is linked with higher firm valuation.

Further reiterating the importance of board of directors is a study by Fama and Jensen (1983) who considers it as one of the main elements of governance. This is further evidenced by Limpaphayom and Connelly (2006) who stressed on the need and the effective characteristic of the role of the board of the directors in overseeing management. Additionally, it has also been argued that elements to governance such as CEO duality, CEO tenure, audit committee

size, board size and board composition have influenced over the firm and its financial performance (Fama & Jensen, 1983; Coles & Jarrell 2001; Weir et al., 2002).

In the context of Kuwait, Kuwait has always been considered as possessing one of the most crucial economies in the Middle East as it is one of the largest oil-exporting countries in the world. Kuwait's economy is characterized by various factors that contribute to the development of industrial and economic development. Although Kuwait's economy is comparatively small, and is characterized as open, the oil industry in Kuwait's accounts for 50 percent of GDP, and 95 percent of exports and 80 percent of government revenues. The crude oil reserve in Kuwait is about 96 billion barrels (15 km <sup>3</sup>) or approximately 10 percent of world reserves (Kuwait Ministry of economies).

Kuwait is considered as one of the richest countries in the Arab and Islamic worlds with its GDP registering its highest in the seventies when it scored 44 percent. However, this speed of economic growth is still insufficient as it has shrunk to a mere 58 percent in the eighties. This was further propelled to increment through the increasing demand for oil, which has assisted to increase the rate to 91 percent during the nineties. Diversification has become a long-term issue for the economy of Kuwait.

The government of Kuwait has undertaken measures to improve its investment climate to make it more attractive to domestic as well as foreign capital investments. For instance, foreign investors are able to take up more than a single license for a number of business activities in Kuwait and a licensed business entity is generally permitted to possess the real estate that is required to carry out business activities as in the case of provision of employees' housing facilities.

Furthermore, foreign investors' sponsorship along with their non-Kuwaiti personnel are left to carry out the company's activities even providing them with incentives to participate in approved industrial and non-industrial activities. These activities are in the form of lower taxation rates, exemption of exports from custom duties. Exemption from custom duties on machinery, equipment, tools and spare parts imported for industrial projects, financial and technical operating subsidies, and provision of land at favorable rents for industrial projects.

As of recently, Kuwait holds the top position among countries, which have facilitated the most bilateral investments (Ahmed & Abdullah, 2010). Based on the World Investment Report of 2010, which brought about the United Nations Conference on Trade and Development in cooperation with the Arab Investment Guarantee Corporation and Export Credit "guarantee", Kuwait is hailed as the first Arab country to achieve foreign direct investment flows amounting to \$ 8.7 billion or 35.8 percent of the total Arab shares, which was followed closely at number two by Saudi Arabia with \$ 6.5 billion or 26.7 percent, along with number 3 by Qatar with \$3.8 billion or 15.4 percent.

Based on a 2006 study by the Arab Forbes Magazine, an assessment of 1616 joint stock companies in the Arab world was carried out and Kuwait was reported to hold the fifth place among the Arab Countries in the list. Additionally, of the 50 best companies that were under study, 25 companies hailed from Kuwait; companies which applied various measures comprising operational efficiency, market value, sales, revenues, dividends, and return on equity (Economic magazine, 2009). In the context of its neighboring country Oman, Claessens (2003) reiterated the necessity of effective corporate governance in Oman's companies owing to the widespread privatization, liberalization, opening up of financial markets and increased delegation of investment. However, the present study will confine

itself to Kuwait and attempt to investigate the effect of CEO duality, CEO tenure, audit committee size, board size and board composition on the performance of Kuwaiti companies listed on the Kuwait Stock Exchange.

## **1.2 Problem Statement**

The significance of corporate governance has recently been acknowledged by both institutions and international organizations, owing to the recent financial crises that occurred in many companies in the developed countries. For instance, the financial meltdown in Latin America back in 1997 and the East Asian financial crisis that took place in Thailand, Indonesia, South Korea and the Philippines; the latter countries have been affected by the moving of foreign investors from the companies in the said countries resulting in the collapse of a large magnitude of property assets.

It has been evidenced that the problem was compounded by the absence of corporate mechanisms in the above countries and the ineffectiveness of the institutions. Similar significant and recent events are the Enron crisis which took place in the U.S. in 2001 and the WorldCom in 2002 which resulted in the further need of corporate measures. Each of these monumental events led to the loss of confidence of potential investors in the accounting procedures (Becht, Marco & Patrick, 2002). Still another case occurred in the U.S. Securities in 2001 whereby the former Executive Director of the Company Sunbeam was indicted in his involvement in illegal activities, with Arthur Anderson which led to a civil penalty and loss of stakeholders' and investors' confidence on the financial system (Rice & Alabama, 2006).

As a consequence of the above financial catastrophes, a great stress was made upon the employment of corporate governance, which is unanimously considered by various writers as

the solution to the problems occurring in the countries' market environment. Majority of researchers hailing from various fields like accounting, economics, administrative, legal, etc. have their studies based on corporate governance for the purpose of highlighting its advantages and positive results (Shleifer & Vishny, 2000).

Among these studies, Ahmed (2010) stated that most Arab studies concentrating at the local and regional level expound on the description of the current corporate governance mechanisms and discuss the structure of system design of governance of shareholding companies. However, a few researches have tackled the impact of corporate governance mechanisms on financial reporting and stresses for thorough studies regarding the mechanisms affect on firm performance.

In the context of Kuwait; the country is still not accustomed to incentive plans which have their basis on the company's performance. Hence, other mechanisms are called for to be created and developed to help evaluate the environment. Along the same lines, Khalil (2005) states that owing to the erroneous financial reporting; the corporate governance in Kuwait needs enhancement for the creation of confidence in the present accounting system. In Kuwait, the problem is linked to the recent collapse of economic units which resulted in the loss of stakeholders along with prospective investors. This compounds the need for the implementation of corporate governance to solve all the problems which led to the subject's world wide popularity in the field of research (Mohammed, 2007).

Similarly, based on Adnan (2007)'s study, corporate governance in Kuwaiti companies can be characterized as weak, lacking transparency and accounting quality, which eventually lead to financial crises in the country. This has also been evidenced by Razan (2007) who stated that effective corporate governance generally leads to the improvement of the company's



performance and their attractiveness to foreign investors which have been declining in recent years.

This belief is further compounded by Haddad (2008) who claimed that the collapse of various economic units stems from investor's loss of confidence on the financial system. Hence, a new system in the form of corporate governance is the best solution for the problems as backed by the statements of various researchers, economists, writers, analysts and others.

Moreover, along similar lines of reasoning, corporate governance have been tackled by many studies and is evidenced to lead to an increase of firms' performances (Baysinger & Butler, 1985; Rechner & Dalton, 1991; Coles & Jarrell, 2001; Rhoades et al, 2001; Khatri et.al, 2002; Judge et. al, 2003; Brown & Caylor, 2004; Klapper & Love, 2004; Chen et al, 2005; Haniff & Hudaib, 2006 and Kajol & Sunday, 2008). On the other hand, other studies (Ertugrul & Hegde 2004 and Kien, Suchard & Jason, 2000) unanimously agree that there is no relationship between corporate governance and firm performance.

Furthermore, it has also been evidenced that capitalistic governments' lack of confidence in the corporation oftentimes results in crisis. Hence, although the board of directors possess the power to look into issues, it is still imperative for shareholders to scrutinize the BOD's decision which is an almost impossible fete as decisions are often carried out in privacy. Eventually, the shareholders have become more dependent on the BOD for the carrying out of tasks for their own advantage.

The above problems justify the objective of the current study which is an attempt to explore the link between board characteristics and firm performance. In the current study, one measures of firm performance will be used for the purpose of studying the relationship; the

power wielded by the CEO will be studied through CEO duality and CEO tenure (Klien, 1998). It is expected that good and effective practice of corporate governance would result in better firm performance. Accordingly, the present study will attempt to explore the relationship between board characteristics (CEO duality, CEO tenure, audit committee size, board size and board composition) with firm performance (ROA).

### **1.3 Research Questions**

In general, this study seeks explanation for the factors that push most of Kuwaiti companies to make the right decision. Specifically, the following research question would be addressed in this study:

1. What is the relationship between CEO duality and firm performance for Kuwait listed companies?
2. What is the relationship between CEO tenure and firm performance for Kuwait listed companies?
3. What is the relationship between audit committee size and firm performance for Kuwait listed companies?
4. What is the relationship between board size and firm performance for Kuwait listed companies?
5. What is the relationship between board composition and firm performance for Kuwait listed companies?

## **1.4 Research Objectives**

In order to examine the impact of corporate governance mechanisms (board characteristics) namely (CEO duality, CEO tenure, audit committee size, board size and board composition) in the context of firm performance (ROA), the following are the objectives of the study:

1. To investigate the relationship between CEO duality and firm performance of companies listed in Kuwait.
2. To investigate the relationship between CEO tenure and firm performance of companies listed in Kuwait.
3. To investigate the relationship between audit committee size and firm performance of companies listed in Kuwait.
4. To investigate the relationship between board size and firm performance of companies listed in Kuwait.
5. To investigate the relationship between board composition and firm performance of companies listed in Kuwait.

## **1.5 Significance of Study**

There are several significances of completing this study. First, this study increases our understanding about the best practice of corporate governance structure in Kuwaiti listed companies. Second, it identifies corporate governance variables, which influence the performance and the productivity of the organizations. Specifically, the importance or benefits of this research accrue to both financial practitioners (investors and creditors) and

academics. Third, this is a study of the few studies that have an elaboration on the corporate governance and its impact on corporate performance in Kuwait.

For the financial practitioners, this research enhances their understanding on which corporate governance mechanisms affects firm performance. For the academics, it will increase their knowledge of the research field in this area by providing additional evidence on corporate governance mechanisms and good firm performance. The significant of this study stems from the need to raise and improve the firm performance through knowing of the factors to impact on the firm performance.

### **1.6 Scope of Study**

This study has been targeted exchange stock companies in Kuwait as a mechanism in generating domestic-led investment to stimulate economic development. The study is conducted only among listed companies that are operating in the non- financial sector in the main board of Kuwaiti Exchange Stock in 2009. Therefore, corporate governance (board characteristics) variables focus only on CEO duality, CEO tenure, audit committee, board size and board composition. In terms of firm performance, this study focuses on ROA.

### **1.7 Organization of Study**

Chapter one is the introduction, in this chapter reader will be provided with research background, problem statement, research questions, research objectives, significance of study, scope of study and the last section in this chapter is the organization of study.

Next chapter is chapter two literature reviews; this chapter includes firm performance, corporate governance, corporate governance in Kuwait, corporate governance (board

characteristics) and firm performance and summary of chapter. Furthermore, third chapter is research methodology, this chapter presenting research method included research framework, hypotheses development, research design, data analysis and summary of the chapter. Fourth chapter is about analysis; this chapter provides a reader with data analysis, which includes descriptive statistics, correlation analysis, multiple regressions, multiple linear regression analysis, discussions of the results and summary will discuss in the last section of this chapter. Chapter five is about the conclusion, this chapter presenting the summary of the study, contribution, limitation and future research.

### **1.8 Summary of the Chapter**

This chapter highlights the introduction of the study and discusses the problem statement. Furthermore, it has presented research questions, research objectives, scope of the study and organization of the study. Literature review will be discussed in the next chapter.

## **CHAPTER TWO**

### **LITERATURE REVIEW**

#### **2.1 Introduction**

The present chapter will explain firm performance, corporate governance, corporate governance in Kuwait and the relationship between corporate governance (board characteristics) namely, (CEO duality, CEO tenure, audit committee size, board size and board composition) and firm performance. Finally, a summary of the chapter will be provided in the end.

#### **2.2 Firm Performance**

The success of the firm is generally explained by its performance that the explanation is about how a firm's performance is over a period of time. Efforts have been expended in determining measures for the concept as it explains a crucial notion. By finding a measure for firm performance, a firm is able to compare its performance through different periods of times. However, to date, no particular measurement has the ability to measure all aspects of performance (Snow & Hrebiniak 1980).

Countless number of ways has been brought forward to measure financial performance and among them are: measurement of performance as the level of profitability (PM), earning after tax (EAT), the residual income (RI), return on assets (ROA), return on earnings (ROE), return on investment (ROI), operating cash flow (OCF), and economic value added (EVA), etc. Most of these proposed measures have been utilized by studies regarding governance.

In some studies, financial performance is measured by the percentage of sales from new products, profitability; capital employed and returns on assets (ROA) (Selvarajan et al., 2007; Hsu et al., 2007). Besides these measures, return on investment (ROI), earnings per share (EPS) and net income after tax (NIAT) are also measures that can be used for the same purpose (Grossman, 2000). It is noteworthy that most researchers are inclined to benchmark managerial accounting indicators against the financial measures in six dimensions; 'workers compensation' (workers' compensation expenses divided by sales); 'quality' (number of errors in production); 'shrinkage' (e.g. inventory loss, defects, sales return); 'productivity' (payroll expenses divided by output); 'operating expenses' (total operating expenses divided by sales) (Wright et al., 2005). Conversely, firm performance can also be measured through 'perceived performance approach', also known as subjective performance measure, where Likert-like scaling measures firm performance from the perspectives of top management perspectives (Selvarajan, 2007).

In the present study, firm performance measures such as ROA is utilized to determine the different affects of corporate governance on the kinds of firm performance. ROA is considered as the profitability ratio calculated as net income divided by total of assets of the company.

Firm performance is greatly influenced by corporate governance and if the functions are suitably set up for corporate governance system, it will facilitate in attracting investment and help in increasing company's funds, strengthen the pillars of the company and in turn, this will lead to the automatic increase of the performance of the firm. An effective corporate governance protects the firm from possible financial suffering and for the purpose of bringing about a remarkable growth, it is imperative for corporate governance to play a crucial role in

the growth of the firm performance. Recently, the influence of corporate governance on the general well being of the firm has been explored (Ehikioya, 2007).

Companies in the countries around the globe have been convinced of the fact that good governance normally leads to positive returns to the firm. Prior empirical studies have created a relation between corporate governance and firm performance (Yermack, 1996; Claessens et al., 1999; Klapper & Love, 2002; Gompers et al., 2003; Black et al., 2003 and Sanda et al. 2003) with evidenciary results. Others, Bebchuk & Cohen (2004), Bebchuk, Cohen & Ferrell (2004) revealed that firms that have corporate governance generally display higher firm performance (Kyereboah-coleman & Biekpe, 2008).

### **2.3 Corporate Governance**

Corporate governance encompasses a wide variety of fields ranging from economics to business, to law and accounting which makes it increasingly complex. The topic of corporate governance is crucial and vital in today's investment environment. The need for the study emerged after the occurrence of several financial crises. As a result, researchers came up with several attempts to define the concept of corporate governance. Accordingly, Morin and Jarrell (2001) consider corporate governance as a framework that controls and safeguards the interests of different players in the market. These players include managers, employees, customers, stakeholders, CEO, shareholder, suppliers and the board of directors of a firm.

The concept of corporate governance has been developed from the agency theory concerning the investor shareholder, manager, administrator and problems that occur and expanded the entire relations between those who are directly or indirectly relate to the affairs of the company (Darwish, 2000). Over the last century, corporate governance has constantly



moved forward and was given the interest and debate it deserved (Parker, 2005). Meanwhile, the rampant corporate frauds and failures fed the interest and placed company directors, accounting regulations, auditors, and in general the accounting profession into the limelight (Parker, 2007).

Adrian Cadbury, Chairman of the Cadbury Company was attributed for the dignity of the first Code of Corporate Governance (1992) with 19 recommendations. His material known as the Report and Code of Good Practices is based on the London Stock Exchange Code. Sir Cadbury is of the opinion that in general, corporate governance works to balance the economic and social goals, the individual and the community, and proposes the most effective harmony as much as possible that satisfies individuals, corporations and society (Cadbury, 2003).

Mathiesen (2002) stated his opinion of the term by stating that corporate governance is the mechanism utilized to protect the shareholders' interest in the market. This is done through the provision of incentives to the managers. This is what Cadbury (1992) meant to say when he suggested that corporate governance generally deals with the value creation of the shareholders through the effective utilization of the firm's assets.

This is consistent with Santosh Shetty (2005) who stated that corporate governance is the framework within which companies are directed and controlled. This shows that corporate governance covers the issues like effectiveness and efficiency of operations, the reliability of the financial reporting (disclosure norms and practices), compliance with laws and regulations and safeguarding of assets. It represents conducting business according to the inclination of the owner or the shareholders which is generally to make as much money as possible without harming the basic rules of society, listed in law and local customs.

According to the OECD corporate governance is a method by which companies are managed and monitored (OECD, 2004).

On the other hand, Denis (2001) states that corporate governance controls the set of institutional and market mechanisms that forces self-interested managers to increase the value of residual cash flows of the firm fulfilling shareholders' interests. Similarly, Monks and Minow (2001) also refers to corporate governance as the mechanism by which the BOD enhances the shareholders' value through the control of manager's actions, CEO and other stakeholders.

In the European Union, provisions relating solely to corporate governance (or binding directive legislation) do not exist although recommendations (implementation into national legislation and or explanation) do (Gregory, 2000). In addition, the European commission is reviewing its legislation in the community action plan for the modernization of law and strengthening corporate governance in the EU, which includes various legislative and other proposals like the introduction of an annual corporate governance statement in the financial statements (Gregory, 2000).

The term govern is referred to as the rule of authority and the term governing can be given the meaning that encompasses a whole variety of actions, initiatives and responses patterns. It comes to reason, therefore, that to govern with responsibility necessitates self-control and self-regulations. Accordingly, Monks and Minow (2008) studied the focus of governance on relations between staff, members of the board, CEO, shareholders and stakeholders, and the interaction among them. According to Shleifer and Vishny (1996) "corporate governance deals with suppliers of financing so make sure you get a return on their investment." Governance is necessary to help direct people and it involves monitoring and overseeing the

strategic direction, the socio-economic and cultural externalities and constituencies of the institution.

Generally, governance is expressed by an agreed upon constitution comprising a complex network of customs and practices existing through a shared system of ethics. There are various governance styles depending on the nature and the size of the organizations. In extreme cases, a style that is based on rules taken up by public sector bodies, are relevant to compliance as opposed to performance. At the other end of the spectrum are churches and clubs which are governed by trust. Various bodies contain a mixed of trust as well as norms in suitable proportions with the logic that holds that trust cannot work with open governance (Morrison et al., 2007).

It was revealed that companies sharing common values with their communities are inclined to result in more sustainable profitability. Therefore, there is a necessity for new structures in order to reflect new and more complex relationships. In sum, corporate governance is an important tool for monitoring performance and enhancing value (Berglof & Thadden, 1999).

At this point, the study has attempted to highlight the principles of the OECD that are crucial to corporate performance. These principles help the initiation of the collection of national codes of corporate governance. They focus mainly on publicly traded companies but they also cover issues to companies possessing a large numbers of shareholders whether they may be public or listed. Some of these principles are listed as follows (OECD, 2003):

1. Shareholders and their legal protection (the right to dividends, and the right to information relevant to the development of society, and the right to actively participate in the vote, and the General Assembly, and monitoring of stock options, etc.).

2. Act at the best level for majority and foreign shareholders.
3. The role and rights of the parties concerned. This applies to the role of suppliers, customers and employees in the company's management and the role that must be respected in accordance with national law, allowing them the opportunity even to participate in the management of the business within the law.
4. Transparency and dissemination of information in a timely manner of information (events for the calculation of all members of the current fiscal year, and administrative staff and emergency services on a regular basis, and timely and accurate, independent audit, it is easy to find the company structure, etc.). The duties of the board of directors and executive committee members of the board of governors of the independent members, and the method of appointment, and reactions, including wages.

The above guidelines were formulated in a general way and hence, leaving various countries to apply them according to their discretion and what the situation calls for. The countries even advise that there is no such intention to introduce a more universal model of corporate governance that is suitable for all, but long-term trend is to come up with standards fulfilling global necessities (Gregory, 2000).

After going through various definitions concerning corporate governance that can be found in literature, the present study agrees with the one provided by Santosh Shetty (2005) which states: Corporate governance is the framework within which companies are directed and controlled. It generally shows the way in which the top management wants to control the activities of the company. Therefore, it is concerned with issues such as the effectiveness and efficiency of operations, the reliability of the financial reporting (disclosure norms and

practices), compliance with laws and regulations and safeguarding of assets. It is the way of conducting business based on the desires of the owner and the shareholders, which is to make as much money as possible while respecting the basic rules of society listed in law and local customs. The OECD refers to corporate governance as the system which manages and monitors companies (OECD, 2004).

### **2.3.1 Corporate Governance in Kuwait**

Despite the significant influence of corporate governance on firm's performance, its cost of capital and its growing popularity in the Middle East and North African (MENA) region. However in Kuwait, its adoption and implementation is still underdeveloped (Ahmad, 2010).

In Kuwait, corporate governance, as similar to in other countries in the region, displays a weakness and is at best sub-par in comparison to the common practices. It is unfortunate that in an economy like Kuwait, knowledgeable individuals that satisfy "fit and proper" guidelines are few and far between and concentrated ownership structures and the small free float of almost all Kuwaiti banks translate to limited numbers on banks' independent boards increasing the risk to minority shareholders and other stakeholders (Adnan, 2008).

In Kuwait, practices of corporate governance have not developed in tandem with the growth of companies and the stock market. Of the six Gulf Cooperation Council (GCC) countries in 2009, Kuwait was listed as the most corrupt country according to the index of perception of corruption. Index number 1 ranks the country as one of the lowest in the GCC countries on the basis of corruption, Index 2 on the basis of competitiveness and Index 3 on the basis of ease of doing business. These statistics are coupled by the fact that Kuwait is characterized by large blocks of holdings and pyramid structures including complex societies. Therefore, the

disclosure practices of transparency and poor and the concentration of power remains in the hands of directors as well as other key management connections. These problems in the face of weak regulatory environment and overall political instability of the country remain the barrier to foreign investment and they undermine investor confidence, generally leads to weak economic growth (Ali, 2010).

### **2.3.2 Corporate Governance (board characteristics) and Firm Performance**

It is generally believed that when firms, markets and countries possess good governance in their system, they display better performance as compared to those government and states firms. In this portion of the paper, a review of the relationship between corporate governance (board characteristics) and firm performance will be carried out.

Corporate governance has been shown to be documented in an effective manner in the literature. For instance, most studies have examined the impact of board characteristics (CEO duality, CEO tenure, audit committee, board size and composition of the Board) on firm performance.

Among those studies, Coles and Jarrell (2001) state that various academic work in the field of corporate governance concentrated on the design mechanisms encouraging managers to reach decisions for the enhancement of firm's performance. These studies however, show contradicting outcomes. As well as, governance mechanisms can be categorized into two broad types namely controls mechanisms of the organization (including the structure of the management structure and board) and incentive mechanisms (including remuneration CEO and ownership structure). While, the finding did not address the importance of the audit committee, which gives high quality to the success of corporate governance standards, which

helps to produce excellent accounting information to give investors the confidence to take decisions in a timely manner.

Another study by Rechner and Dalton (1989) who studied shareholder returns for five years (1978-1983) of companies belonging to 141 Fortune 500 and the result revealed no significant difference between the performance of a separate structure and spin. Nevertheless, in 1991, when the study was viewed from another angle and examined with similar accounting measures based on company performance such as ROE, ROI and profit margin, it was found that the separated structure firms showed better performance when compared to combined structure firms. Meanwhile this study did not address the importance of the audit committee, board composition, CEO tenure and CEO duality. As these factors are of crucial importance in improving the company's performance and give real-time information and clear to investors to help them make their decisions in the future.

A study carried out by Rhoades et al. (2001) involving the meta-analysis of 22 samples found a weak but significant relationship between leadership structure and firm performance. It was revealed that companies possess distinct structures with CEO duality, delivered greater performance. All the mentioned studies however, were based on major U.S. corporations. However, the sample did not focus on small businesses, where small businesses are owned by small and middle owners accounting for the largest of its investors. This study recommends the application on small companies because of their importance to know the weaknesses of the application of governance and learn how to improve the performance of the company. And also focus on the importance of the audit committee for its role in improving the company's performance and the application of governance.

Other regions indicate dissimilar findings. For instance, in Russia, Judge et. al (2003) distributed questionnaires to 116 Russian managers analyzing the relationship between board structure and firm performance. From 1996, the Russian Federal Law has prohibited CEO duality. Nevertheless, Judge et. al. argued that the CEO could still “informally” influence the BOD and consequently affect firm performance. The researchers concluded from the study that although the relationship between CEO duality and performance is ambiguous in the developed economies, in Russia, there is a strong negative relationship between the informal CEO and firms. But they did not use data collection through the financial statements that show real weaknesses. Meanwhile, the interview conducted did not reveal fully the imbalance within the financial statements. Likewise, this study did not address the importance of the audit committee. Therefore, the effective application CEO duality, CEO tenure, size of audit committee, board size and board composition will help companies provide the right information to the beneficiaries.

In the Asian context, Chen et al (2005) analyzed 412 companies listed in Hong Kong for the years 1995-1998, in order to study the mechanisms of corporate governance comprising particularly CEO duality, the composition of the BOD, audit committee and their influence on performance, value and dividend distribution companies under family control. The researchers took the measurement of performance of the company with the help of three variables which are ROA, ROE and market to book value. The outcome of the study revealed a negative relationship between CEO duality and performance (ratio of the book market). The relationship remained significant even after the industry was controlled and the effects of the firms were fixed. The authors came to the conclusion that CEO duality is linked to lower valued companies displaying poor performance. Nevertheless, this study did not conduct



board size and CEO tenure. Board size and CEO tenure have an effect on firm performance to give the right information about companies and thus, to attract investors.

Various other studies regarding corporate governance concentrated on the Council's composition and its influence on performance. Among these studies was a study carried out by Baysinger and Butler (1985) whose results displayed weak evidence stating that firms having more external directors in 1970 displayed higher performance on the basis of ROE in 1980. It was concluded that society run by non-executive directors are better companies in terms of performance as compared by those run by executive directors. On the other hand, Klein (1998), divided the company into various committees and concluded that the higher percentage of managers within the committee of finance and investment leads to better stock market performance. The author's findings revealed a positive relationship between inside director and firm performance. However, this study did not include board size, board composition and size of audit committee which help companies to improve their performance among stock-market to give a clear picture to all users of financial statement.

Hudaib and Haniff (2006) studied the relationship between six corporate governance (board characteristics) variables (board size, board composition, leadership CEO duality, the concentration of ownership and management participation) and two measures of performance (Tobin's Q and ROA) in Malaysia. The researchers' study involved 347 companies listed on the KLSE between 1996 and 2000. The results revealed a significant relationship between board size and ownership concentration (measured from the top 5 major holdings) and both market and accounting performance measures. Board size was found to be negatively related with the market trend due to the fact that market views the board as ineffective, but at the same time, board size had a positive correlation with the performance of accounts.

Participation was found to have a negative correlation with market trends indicating that market performance is better for companies with broad ownership. Also, there was a marked positive correlation with the performance of accounts revealing that Malaysian companies produce better financial results for ownership concentration.

In the same study, the authors also revealed a significant negative relationship between management ownership and market performance and when market performance improved, multiple administrators lose their meaning. In addition, the authors found that CEO duality has a significant negative relationship with accounting performance of companies with a mixed structure and displayed a weaker performance in accounting. Finally, the authors found a significant negative relationship between management ownership, accounting performance and concluded that the insider model of corporate governance is not suitable for the Malaysian business environment. On the other hand, this study did not add the size of audit committee. Given the impact of this factor on the performance of the company in the stock market in order to attract investors and give them confidence about investment decisions.

Similarly, Khatri et.al (2002) examined the performance of the business sector (efficiency) and the role of corporate governance (high leverage and concentration of property) in Malaysia through the assembly of a panel data of 31 major non-financial companies listed on KLSE for the period 1995-1999 in a stochastic frontier. The results revealed the importance of the concentration of ownership and explanatory power that provides evidence of a positive relationship between inefficiency and the system of cross shareholdings and ownership of companies or mergers whose high ownership concentration are ineffective.

Consistent with the above results, Brown and Caylor (2004) took another approach in evaluating corporate governance and firm performance through the creation of a broad measure of corporate governance and studying Gov-score comprising 51 factors in eight corporate governance categories based on a dataset provided by Institutional Shareholder Services. The authors then related Gov-score to operating performance (ROE, profit margin and sales growth), valuation (Tobin Q) and shareholder payout (dividend yield and share repurchases) for 2,327 US firms and revealed that better governed firms to be more profitable, more valuable and they pay out more cash to their shareholders. The firms' good governance is measured through the use of executive and director compensation that is linked with good operating performance. In addition, good governance measured by Charter and bylaws focusing on anti-takeover measures is revealed to be highly related to bad operating performance. A caveat was included in the conclusion stating that although the results display a link between good corporate governance and performance, it is not necessarily an evidence of causality.

Klapper and Love (2004) made use of ranking of governance developed by Credit Lyonnais Securities Asia (CLSA) to compare the performance (Tobin Q and ROA) of a total of 374 firms across 14 emerging markets. The outcome indicated that corporate governance correlates highly with better operating performance and market valuation. And also in the study by adding the size of the board, the Council's composition, CEO duality, CEO tenure and size of the Audit Committee, it is noticed that the company's performance is better than before because of these factors impact on the company's performance and help improve the accounting information showing the financial position of the company. It works to make information more transparent and objective.

The examination of the relation between corporate governance and firm performance in Nigeria by Kajol and Sunday (2008) was carried out by studying two proxies (ROE and PM) and four corporate governance mechanisms (size, board composition, management and audit committee ) comprising 20 non-financial companies listed on the Nigerian Stock Exchange between 2000 and 2006. The method used which consisted of dataset, multiple regression analysis and estimation method is OLS. The results revealed a positive and significant relationship between ROE and the size of the firm. There exists a positive and significant relation (at 10%) between the ROE and the CEO while no significant relationship was established between ROE and the composition of board and committee verification. Also, a positive and significant relationship exists between PM and CEO while no significant relationship was established between PM and the size of the board, as well as board composition and audit committee.

The study urges a more in-depth look into small and medium scale firms in the African Continent owing to the firm's characteristics of representing 90% of the total enterprises in the region. The necessity of examining the relationship between measures of corporate performance, when the lever is in place results in a more robust outcome. Additionally, the empirical literature reveals an array of bias against larger companies. Therefore, it was suggested that more concentration should be dedicated to the study of small and medium enterprises in Africa because of their large representation. Hence this study will investigate the relationship between corporate governance mechanisms (board characteristics) namely (CEO duality, CEO tenure, audit committee size, board size and board composition with firms performance.

### **2.3.2.1 CEO Duality and Firm Performance**

One aspect of corporate governance, which has given rise to concern, is the dominant personality' phenomenon that includes role duality, where the chief executive officer (CEO) or managing director is also the chair of the board. The agency theory argues that in favour of the separation of the CEO and chairman within the organization as it is imperative to establish efficient and effective check and balance by the board and CEO; non-duality leads to better performance than their counterparts without separation i.e., CEO duality (Fama & Jensen, 1983 and Ramdani & Witteloostuijn, 2009).

Alexander, Fennell and Halpern (1993) argue that CEO duality plays an important role in affecting the value of a firm. A single person being the Chairman and the CEO leads to the enhancement of the firm's value and the cost between the two is eliminated. However, White and Ingrassia, (1992) indicate that CEO duality can lead to the board's worse performance as the board is unable to remove the underperforming CEO which can generate agency costs in cases where the CEO works for his own interest as opposed to the shareholders. Yermack (1996) argue that, when the CEO and board chair positions are separate, it increases the firm's value. Fama and Jensen (1983) argue that CEO duality in a firm favours the underperforming CEO as it is difficult for the board to remove them.

There are several studies which have examined the relationship between CEO duality and firms performance. By using sample of US companies, Donaldson and Davis (1991) study the relationship between CEO duality and firms performance, their study found that there is a positive relationship between CEO duality and performance and they concluded that companies of duality, demonstrated a greater return on equity (ROE) and shareholder wealth

compared to other companies even after including a factor of restraint and the regime of long-term compensation to align the interests of management to shareholders in the study.

Similarly, a study of the leadership council of the largest Australian listed companies show similar results, where CEO duality has a positive relationship with both market return (measured by Tobin's Q) and performance measured by ROA (Kiel & Nicholson, 2003). These results are crucial in terms of the impact on policies and practices of the board Administrative leadership in Australia because unlike in the U.S., majority of Australia's companies have an independent chairman and CEO.

According to the results reached by the Rebiez and Salamenh (2006), in their study of governance structure and financial performance in the construction sector, a positive linear relationship exists between the independence of the CEO and president or chairman and CEO of return on the market. However, a weak relationship (6%) can be found on the variation in market returns as explained by the type of management structure. This result is consistent with an earlier conclusion by Dahya, Lonie and Power (1996) in the context of listed UK companies. The authors found that CEO duality is negatively related to performance of the stock market and accounting performance. Rechner and Dalton (1989) in their study of CEO duality in the longitudinal analysis also found a positive relationship between the separation of the roles of CEO and Chairman, and performance.

By exploring samples of Fortune 500 companies, Rechner and Dalton (1991) found that companies with CEO duality have stronger financial performance. Goyal and Park (2002) also found that companies without CEO duality possess lower sensitivity of CEO turnover to firm performance. Sanda, Mukaila and Garba (2003) did a study on the performance of Nigerian companies and revealed a positive correlation between separating the functions of

the CEO and Chairman and firm performance. Also, Boyd (1995) found a positive relationship between performance of US firms and CEO duality. However, Vafeas and Theodorou (1998) and Baliga, Moyer and Rao (1996) have found no significant association between CEO duality and firm performance.

According to Goyal and Park (2002), a person holding both the top positions is contrary to corporate governance principles. Also, there is negatively affects the value of a firm as the board cannot hold the CEO accountable. And hence, they found that the firm's value is negatively affected owing to the lack of monitoring of CEO.

Finally, Ramdani and Witteloostuijn (2009) concluded that CEO duality has an effect on firm performance solely on firms displaying average performance as opposed firms performing below or above par. Similarly, according to the results by Haniffa and Hudaib (2006), despite role duality being uncommon in Malaysian corporations, companies with role duality seemed to perform worse than their counterparts with separate board leadership. Ultimately, a study by Brickley, Coles and Jarell (1997) carried out to determine the impact of corporate governance practices on firms' financial performance on Malaysian companies revealed that the CEO duality has no effect on firm performance.

#### **2.3.2.2 CEO Tenure and Firm Performance**

The leadership position of CEO in many studies has been measured by the number of years in leadership position. Directors generally have limited tenures in their positions and require the re-selectmen of the board in a frequent manner. This is done to prevent the provision of excessively long-term contracts which leads to the increase in the cost of management dismissal in case of poor performance.

The issues in agency theory have their basis on two fundamental assumptions namely goal incongruence and information asymmetry (Chakravarty & Zajac, 1984). The former is considered to be partially differing objectives of the principal and the agent, which concerns issues of adverse selection and moral hazard. This is linked to the lack of transparency in the actions and the decisions taken by the agent. Due to the inherently non-transparent nature of actions taken by the agent, a principal who seeks to limit a divergence from his own interests must think of a way to monitor the outcome of the agent's actions. Hence, published performance poses as a strategic variable for the CEO, and could therefore hold specific activities of discretion on his part to secure a higher position.

Several studies which investigate the relationship between CEO tenure and firms performance have found mixed results. Kyereboah-Coleman (2007) found that there is negative relationship between CEO tenure and firms performance. Performance-related turnovers are clearly observed in cases where the CEO left before retirement. In other words, the shorter the CEO's tenure, the poorer is his performance. However, in cases where the top executive remains longer in a company until normal retirement age, performance is not an explanation for the change in CEO turnover. From another angle, longer CEO tenure means that the CEO is able to exercise power based on the argument from information asymmetry or CEO might have an indirect control of the board of director.

Finkelstein and Hambrick (1989) found no significant relationship between CEO tenure and firms performance. After a few years in any organization, the CEOs prefer to have other form of remuneration in addition to cash compensation. It was later confirmed by Garen (1994) who found that 76% of the total incentives of CEO are stock based incentives, which are three times greater than pay based incentives. Finkelstein and Hambrick (1989) argued that



the total compensation and salaries of CEOs were not impacted by their general management experience but were impacted by bonuses associated to it.

On the other hand, Carothers (2004) revealed that salary of a senior executive is statistically associated with the number of years he has been the CEO to the company. Hill and Phan (1991) argued that age and ownership have little or no effect on CEO compensation. Contrarily, Bertsch and Mann (2005) found a strong correlation between CEO compensation and ownership. Once again, there is no consensus on whether CEO tenure may be used to determine CEO compensation or not.

### **2.3.2.3 Audit Committee Size and Firm Performance**

An audit committee refers to a committee of board operation who is generally responsible to oversee the financial reporting and communication in the firm. The committee provides an invaluable communication between the internal and external auditors and the board helps to ensure it covers all issues relevant to the audit. According to Mallin (2007) the main objective of committees is to help the Council in effectively carrying out their fiduciary responsibility for corporate governance, financial reporting to shareholders and the public and internal control.

It is imperative for the board to set up an audit committee comprising at least three members who are non-executive directors, or two members in small businesses (Mallin, 2007). Kajol and Sunday (2008) argue that increase members in the committee suggest more experts available at hand for the overlooking of internal controls and financial reporting. Various accounting standards and principles must guarantee that general rules and regulations are

employed by accountants in a large scale when they prepare financial statements and reports reflecting the exact state of the company (Yan, Jian and Nan, 2007).

Few literatures which investigate the relationship between audit committee size and firms performance found mixed results. Kyereboah-Coleman (2007) found that there is positive relationship between audit committee and firm performance that the related to the effectiveness to monitor mistakes in the financial reporting process. He indicated that increasing of the capacity of the audit committee size may lead to positive achievement on the firm performance.

By using sample of 122 companies in U.S, Klein (2002) investigates the relationship between audit committee size and earning management. The results of this study indicated that there exists a negative correlation between earnings management and audit committee size. They found that when the capacity of audit committee size is big that it may leads to decrease firm performance.

#### **2.3.2.4 Board Size and Firm Performance**

Board size which is the number of directors on board is an important factor in the effectiveness of the board. Jensen and Meckling (1976) argue that increase board size will lead to improve companies' board effectiveness and support the management in reducing agency cost that resulted from poor management and would lead to better financial results. The Chairman should be allowed to provide commands to all the executive and non-executive directors. According to researchers, the board size should be of a total of five to fifteen persons (Ogbechie, Koufopoulos & Argyropoulou, 2009).

There have been many studies that examined the relationship between board size and firm performance in Japanese listed companies, Yokishawa and Phan (2004) found that there is a negative association between board size and firm performance. In addition, Shakir (2008) found a negative relationship between board size and firm performance which supports a suggestion by Jensen (1993) who stated that for a firm to be effective in its monitoring, it should have a relatively small board of directors. According to Haniffa and Hudaib (2006) suggest that a large board is seen as less effective in monitoring performance and could also be costly for companies in terms of compensation and increased incentives to shirk. In the context of Canadian public companies, the board size was also showed as having a negative relationship with performance measured by return on sales, sales efficiency and ROA (Bozeman, 2005).

On the contrary, prior studies regarding the size of the board provided a good relation between the size of the board of directors and corporate performance. Large boards are viewed to lead to better business performance owing to the wide variety of skills presence for better decision making and monitor the performance of the CEO. In a related study, Mak and Li (2001) found an affirmative correlation between firm size and the social return following their OLS regression but their results do not support the test. The study comprised 147 companies in Singapore from the 1995 data.

Similarly, Adams and Mehran (2005), found a positive relations between board size and performance in U.S. banking industry. Dalton and Dalton (2005) have also reported that large boards are associated with stronger performance. Consistent to the above results, Pfeffer (1972) and Zahra and Pearce (1989) presented similar views about the board size and firm

performance. The authors suggested that a bigger board is better for the firm due to the higher number of directors that makes the jury more competent and skilled.

#### **2.3.2.5 Board Composition and Firm Performance**

Board composition has been highly debated in the realms of economics, organizational science literatures, and finance on the empirical and on the theoretical level. It has also been debated that effective ways of monitoring can assist the boards in making executives effectively take on shareholder's interest rather than their own (Ramdani & Witteloostuijn, 2009). Similarly, Young (2003) enhanced director independence is intuitively appealing owing to the fact that a director having ties to a firm or the CEO of the firm would not turn down an excessive pay packet, challenge the rationale behind a proposed merger or bring to bear the skepticism necessary for effective monitoring.

According to agency theory, a larger proportion of independent directors generally provide better firm performance. Similarly, according to Ramdani and Witteloostuijn (2009) the proportion of independent directors has an effect on firm performance for firms with average performance, and not for firms performing below or above par.

Previous studies that investigate the relationship between board composition and firm performance found mixed results. Forsberg (1989), Hermalin and Weisbach (1991), and Zahra & Pearce (1989) found that there is no significant relationship between board composition and firm performance. On the other hand, other studies found firms with boards of directors dominated by outsiders are able to perform better ( Weiback 1988; Resenstein and Wyatt, 1990; Mehran, 1995 and John and Senbet, 1998).

Moreover, Forsberg (1989) found no relationship between the proportion of outside directors and various performance measures. Generally, effective boards contain a great proportion of outside directors. In a similar study, Kosnik (1987), Kyereboah-Coleman and Biekpe (2005) found a positive association between proportion of outside board members and performance. Therefore, it can be said that some studies support the agency theory (Klein, 1998; Daily & Dalton, 1993; Pearce & Zahra, 1992; Baysinger & Butler, 1985). Hermalin and Weisbach (1991) and Bhagat and Black (2002) found there is no relation between the degree of board independence and four measures of firm performance. The authors revealed that poorly performing firms were more likely to increase the independence of their board.

## **2.4 Summary of Chapter**

The present study attempts to investigate the relation between corporate governance and firm performance. Within Chapter One, the prior studies pertaining to corporate governance and firm performance are discussed. The Chapter covers the discussion pertaining to firm performance, corporate governance, corporate governance in Kuwait and the relationship between corporate governance (board characteristics) variables, (CEO duality, CEO tenure, audit committee size, board size and board composition) and firm performance. The next chapter will present the hypotheses development as well as the methodology of the study.

## **CHAPTER THREE**

### **HYPOTHESIS DEVELOPMENT AND METHODOLOGY**

#### **3.1 Introduction**

The chapter expounds on the theoretical framework according to the agency theory and hypotheses formulation. This is followed by the explanation of the research methodology assisting the investigation and the analysis step. Then the chapter provides a description of the research process initiating with the research design, namely data collection, procedures of data collection, model specification and multiple regressions and measurement of the variables. Next, the chapter provides a description of data analysis namely, descriptive analysis, correlation of variables and multiple linear regression analysis. Finally, the summary of the chapter.

#### **3.2 Research Framework**

The present study makes use of agency theory in the examination of the relationship between corporate governance (board characteristics) and firm performance. On the basis of agency theory, the main problem is explained by the agency appears under conditions of incomplete information and asymmetric. Another indication that the issue of key factors in most of the relations of employers and employees. For instance, when shareholders recruit senior executives from companies. It can use different mechanisms to try reconciled the interests of the agent with the principal's interests.

According to the agency view that the delegation of administrative responsibilities, which usually provide for school administrators and agents calling to make use of mechanisms to

reconcile the interests of principals and agents and monitors the performance of managers in ensuring that the authority delegated result in the highest possible returns. Consistent with this, Kyereboah-Coleman and Biekpe (2005) found that the agency theory arranges the relationship between board characteristics and firm performance.

Agency theory may lead to organize the relationship between the owner and manager, and contributing to the separation of functions and works to strengthen trust between owners and managers, and thus, it helps the company to improve performance and increase the value of the company (Jensen & Meckling, 1976). One of the main mechanisms that provides the monitoring function is crucial in dealing with the problems of the agency board of directors (Lefort & Urzua, 2008). Arguably, the board of directors play a crucial role in protecting the interests of shareholders of the various interests of the self-management. The best solution to some agency problems in the modern corporation lies in the function of the board of directors (Hermalin & Weisbach, 2003).

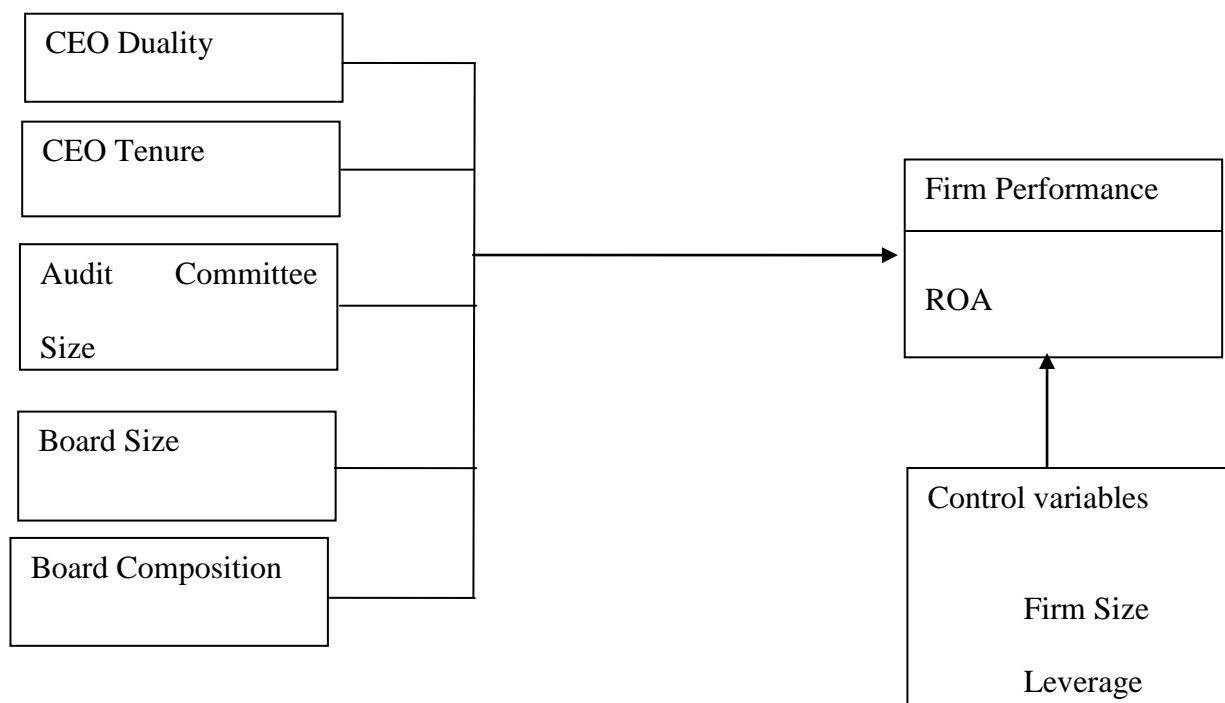
The primary goal of the board is to reduce agency costs, increase disclosure of information that serves the stakeholders, and work to increase the shareholder interests (Fama & Jensen, 1983). Based on the De Andres et al (2005) and Abdullah (2004), the board can be enhanced through the formation of the board, its size, and its structure, which may help to improve performance, and work to do strategic plans and implementation in the manner required.

Hypothetically, the board has to bear all responsibilities for the company's operations, its financial viability and ensure that it meets the requirements of the company and the interests of shareholders and also, the board plays a crucial role in affecting the firm's financial performance (Fama & Jensen 1983; Coles & Jarrell, 2001). Prior empirical studies reveal that the relationship between CEO duality, CEO tenure, audit committee size, board size and

board composition and firm performance have mixed results (Baysinger & Butler, 1985; Rechner & Dalton, 1991; Kien, Suchard & Jason, 2000; Coles & Jarrell, 2001; Rhoades et al, 2001; Khatri et.al, 2002; Judge et. al, 2003; Brown & Caylor, 2004; Ertugrul & Hegde 2004; Klapper & Love, 2004; Chen et al, 2005; Haniff & Hudaib, 2006 and Kajol & Sunday, 2008).

The present study attempts to investigate the relationship between the board of directors' characteristics comprising CEO duality, CEO tenure, audit committee size, board size and board composition with firm performance (ROA) in Kuwaiti listed companies. These named board characteristics are considered as the independent variables, and they will be examined against the firm's performance (i.e. ROA) which represents the dependent variable.

Figure 3.1 presents the research model of the present study including all respective variables. The discussion and explanation of each variable as well as the hypotheses development will be laid down in detail in the following paragraphs.



**Figure 3.1: Theoretical Framework**



### **3.3 Hypotheses Development**

This section will provide the relationship between firm performance (ROA) as dependent variables with board characteristics namely, CEO duality, CEO tenure, audit committee size, board size, board composition as independent variables.

#### **3.3.1 Firm Performance**

The firm performance is considered as the dependent variable in the present study as firm performance indicators represent return on asset (ROA).

ROA widely differs in various companies and represents the measure of efficient use of assets. ROA is normally an effective indicator of the profitability of the company and the business as compared to a benchmark rate of return equal to the risk adjusted weighted average cost of capital. In addition, ROA measures the operating and financial performance of the firm (Klapper & Love, 2002). Thus higher ROA presents the effective use of assets for the shareholders' advantage (Haniffa & Hudaib, 2006).

Based on Miller et al. (2001), ROA represents a measure for gauging the overall efficiency of which the firm's assets are utilized for the purpose of net income production from firm operations. Also, the authors stated that ROA is evidence of effective management in allocating capital as there is a possibility of the firm being efficient but yet poorly able to utilize capital.

ROA has been used widely in corporate governance studies such as (Baysinger & Butler, 1985; Rechner & Dalton, 1991; Coles & Jarrell, 2001; Rhoades et al, 2001; Khatri et.al, 2002; Judge et. al, 2003; Brown & Caylor, 2004; Klapper & Love, 2004; Chen et al, 2005;

Haniff & Hudaib, 2006 and Kajol & Sunday, 2008). In the present study, concentration is provided to independent variables such as CEO duality, CEO tenure, audit committee size, board size and board composition. This section of the paper, discusses these variables that will guide the study of its results compared to prior studies. The objective lies in the examination of the impact of these variables upon firm performance. The following section will expound on all the independent variables and the sole dependent variable.

### **3.3.2 CEO Duality and Firm Performance**

Agency problems are generally higher in cases whereby the same individual holds dual positions, in this case when the CEO also acts as the chairman of the board. According to agency theory, this is likely to lead to misuse of power and resources as the individual will be very influential and there will be a lack of checks and balances to monitor his actions.

According to Jensen and Meckling (1976), duality of position often times lead to the individuals pursuant of his personal interest which harms the firm in totality. This is evidenced by Mallette and Fowler (1992) who stated that in duality, there is a strong possibility of conflict of interest. Additionally, in duality, the CEO is able to set the board's agenda and influence their decisions. The authors concluded that CEO duality leads to challenging the board's ability to do their monitoring duties, where it may lead to weak performance of the company. Also, Rechner and Dalton (1991) advised that for the purpose of facilitating a more effecting monitoring and controlling of management, the agency theory suggests separating the Chairman from the CEO because the separation of functions helps to improve performance, and improves the implementation of strategic plans. Furthermore, it has been argued that firms who fail to separate the two roles normally underperform. This view is further evidenced by Jensen (1993) who stated that separating the two roles is

imperative in order to guarantee board effectiveness which eventually will result in an increase in the firm value (Yermack, 1996).

According to several researchers such as, Ramdani and Witteloostuijn (2009), they argued that CEO duality's impact on the performance of the firm is only manifested by firms with average performance as opposed to those under or over-performing firms. By and large, the cases where the roles are separated improve firm performance. The CEO duality generally leads to low firm performance. This evidence is further supported by Mallin (2007) who stated that the roles of the CEO and Chairman should be separated and given to two different individuals (Haniffa and Hudaib, 2006). Similarly, Bhagat & Black (2002), Yermack (1996), Sanda, Mukaila and Garba (2003) find that firm value is increased in cases where the two roles are separated and may lead to help the company to implement its plan.

In accordance with the Combined Code (2006) a chief executive should not go on to be chairman of the same company because it may help to reduce information disclosure to all shareholders. Similarly, Judge et al. (2003) and Feng et al. (2005) found that there exist a negative significant relationship between CEO duality and firm financial performance. On the contrary, Schmid and Zimmermann (2007), Wan and Ong (2005) and Carapeto et al. (2005) concluded that there is no significant difference in the performance of companies either with or without the role of duality. While Kyereboah- Coleman and Biekpe (2005) stated that firms with separation of roles consistently displayed higher performance because the owner of the company will be particularly keen on his business, and he is highly experienced, and this main goal is to increase the value of the company's assets. Ultimately, a study by Brickley, Coles and Jarell (1997) carried out to determine the impact of corporate governance practices on firms' financial performance on Malaysian companies revealed that the CEO duality has

no effect on firm performance. Based on the theoretical evidence, therefore, it is hypothesized:

**H1: There is a relationship between CEO duality and firm performance.**

### **3.3.3 CEO Tenure and Firm Performance**

Based on the agency theory, tenure suggests CEO's asymmetry with the company turnover's information and they have control over the decisions making. However, it has been argued that the tenure of the CEO constitutes another governance mechanism. Bertsch & Mann (2005) stated that a strong relationship exists between CEO pay and tenure because, the owner of the company will be particularly keen on its business, and he is highly experienced, and the main goal of increasing the value of the company's assets. Additionally, Kyereboah-Coleman (2007) concluded that CEO tenure in office improves the profitability of the firm. The author argues that when a CEO has a longer tenure, it adds as an incentive that promotes shareholders' interest owing to the fact that the CEO becomes a witness to the outcome of his decisions.

On one hand, Carothers (2004) revealed that salary of a senior executive is statistically associated with the number of years he has been the CEO to the company. Hill & Phan (1991) argued that age and ownership have little or no effect on CEO compensation. In contrast, Bertsch & Mann (2005) found a strong correlation between CEO compensation and ownership. Once again, there is no consensus on whether CEO tenure may be used to determine CEO compensation or not. Finkelstein & Hambrick (1989) found no significant relationship between CEO tenure and firm's performance that the total compensation and salaries of CEOs were not impacted by their general management experience but were

impacted by bonuses associated to it. Based on the theoretical evidence, therefore, it is hypothesized that:

**H2: There is a relationship between CEO tenure and firm performance.**

### **3.3.4 Audit Committee Size and Firm Performance**

The larger the size of the audit committee, the more the experts will be available to monitor and check the financial reports and give confidence to the shareholders. The Cadbury Commission suggested the number of audit committees to be at least three. Kajol and Sunday (2008) argue that increase members in the committee suggest more experts available at hand for the overlooking of internal controls and financial reporting. Various accounting standards and principles must guarantee that general rules and regulations are employed by accountants in a large scale when they prepare financial statements and reports reflecting the exact state of the company (Yan, Jian Nan, 2007). According to Kyereboah-Coleman (2007), a positive relationship exists between the size of audit committee and performance and its independence is evidenced to be positively related to the effectiveness to monitor mistakes in the financial reporting process. Contrarily, Klein (2002) stated that there exists a negative correlation between earnings management and audit committee independence. Based on the above, the following hypothesis is formulated:

**H3: There is a relationship between audit committee size and firm performance.**

### **3.3.5 Board Size and Firm Performance**

Board size is generally believed to impact the monitoring strength and larger boards are believed to act as a more capable monitor of top management (Abdullah, 2004). It is however clear that larger boards lead to a disadvantage in the form of higher spending on the maintenance in addition to difficulties in planning, work coordination, decision-making and holding regular meetings owing to the large number of members. Contrarily, smaller boards can help avoid free riding by individual directors, and increase their decision taking processes.

According to Lipton and Lorsch (1992) a notable increase in the size of the board might lead to a less effective monitoring of management. The authors suggest the board size to be composed of between eight or nine members and any additional advantages from the increased monitoring by additional members will nullify the costs related to slow decision making, and to efforts expended. This is manifested by the firm's financial performance as clearly presented in Tobin's Q, the ROA measures utilized in the study. This is further evidenced by Jensen (1993) stating that the board of directors become less effective when their number increases over 7 or 8 members. Similarly, Lipton & Lorsch (1992) and Jensen (1993) concluded that large boards are less effective and there is a possibility that discussion among the members become less meaningful. With an increase in board size, difficulties arise concerning co-ordinating and processing problems.

There are some empirical research findings which support the arguments such as studies by Haniffa and Hudaib (2006), Hermalin and Weisbach (2003), Yermack (1996), Vafeas (2000), Mak and Yuanto (2003) and Yokishawa and Phan (2004); studies which revealed a negative link between board size and firm performance. This is further evidenced by Shakir (2008)

who also found a negative relationship between board size and firm performance. On the contrary, Mak and Li (2001), Adam and Mehran (2005), Pfeffer (1972) and Zahra and Pearce (1989) and Dalton and Dalton (2005) found a positive relationship between the two. Therefore, based on the theoretical perspective and discussion above, the following hypothesis is formulated:

**H4: There is a relationship between board size and firm performance.**

### **3.3.6 Board Composition and Firm Performance**

Board of directors comprises both inside and outside directors. The latter are individuals serving on the board but are not acting in any executive capacity. Based on Jensen and Meckling (1976), boards that are mainly dominated by outside directors or non-executive directors (NED) may assist in mitigating the agency problem through their monitoring and controlling of the opportunistic activities of management. While Baysinger and Butler (1985) evidenced the notion by stating that NEDs generally provide superior performance to the firm because of their nature of independence from the firm which constitutes a crucial characteristic of the board that determines the effective way in which it monitors management (Fama & Jensen, 1983).

To achieve board decisions' objectivity, it is crucial to retain a balance of independent non-executive directors (Mallin, 2007). On the other hand, Cabdury (1992) concluded that apart from the director's fees and shareholdings, NEDs should be independent from management and they should be excluded from any business or other links which could influence their exercise of autonomous judgment. The OECD (2004) similarly stated that board

independence normally calls for a sufficient number of board members that are completely separated from management.

Generally, studies have shown a positive impact of the board composition upon performance as evidenced by Kosnik (1987), Kyereboah-Coleman and Biekpe (2005), Yermack (1996) and Zahra and Pearce, (1989). Among the studies, Millstein and MacAvoy (1998) revealed a positive relation of independent board upon U.S. corporations overall performance. Moreover, the High Review (2003) also stated that the strength of the board is signified by the strong group of non-executive directors having no links with the management of the company. This is due to the fact that these individuals bring objectivity to their decisions that directors with links to management generally fail to provide. On the other hand, Haniffa and Hudaib (2006) and Mac Avoy, Dana, Cantor and Peck (1983), Baysinger and Butler (1985) and Klein (1998) concluded in their study by stating that a proportion of independent directors fail to impact performance. Similarly, Ramdani and Witteloostuijn (2009) also revealed that a major proportion of independent directors do have an impact on firm performance but only for firms displaying average performance as opposed to those that are above or below par. Based on the theoretical perspective and discussion above, the following hypothesis is formulated:

**H5: There is a relationship between board composition and firm performance.**

### **3.4 Research Design**

To achieve the purpose of this study, the correlational studies are used to search for relationships between COE duality, CEO tenure, audit committee size, board size and board composition as independent variables and firm performance (ROA) as dependent variable.



### **3.4.1 Data Collection**

The total number of companies listed on the Kuwait stock exchange numbered 228. All of them are categorized into groups similar to how they were on the Stock Exchange. The study population comprises non-financial firms listed on the Kuwait stock exchange ([www.kuwaitse.com/portal/a/stock/companies.aspx](http://www.kuwaitse.com/portal/a/stock/companies.aspx)). According to the above body, there are 136 non-financial companies included on the main board and secondary board as of 20th September 2009. Owing to the differences that lie in the regulatory requirements as well as the characteristics of the financial reports which are distinctive from non-financial firms, banks and financial institutions have not been included in the present study (Alsaeed, 2006).

Therefore, only the information provided for the 136 non-financial firms is retrieved and the study is based on these 136 non-financial firms. As mentioned before, the choice for the year 2009 is opted due the fact that 2009 is the most advanced source of information at the initiation of the study.

In sum, the study specifically employs secondary data based on the financial statements of a total of 136 non-financial firms listed in the Kuwait stock market and the use of these particular documents owes itself to convenience, availability and reliability. The objective behind the study is the examination of the influence of the board of director's characteristics such as CEO duality, CEO tenure, audit committee size, board size and board composition on the firm's performance which is measured by ROA.

#### **3.4.1.1 Procedures of Data Collection**

The data necessary for the study of corporate governance (board characteristics) and firm performance were retrieved from the annual reports of the companies that listed in the official

trading market stock website as known Kuwait stock exchange ([www.kuwaitse.com/portal/a/stock/companies.aspx](http://www.kuwaitse.com/portal/a/stock/companies.aspx)). For the data needed for corporate governance, they are collected from the annual reports in particular from the portion expounding on corporate information and statement of corporate governance as well as from the director's profile. As for firm performance, data regarding it are taken from business statements like balance sheet, income statement, and cash flow statement provided in the annual reports.

Secondary data were collected owing to the ease of availability and for the purpose of answering the research question; the entire data needed were taken from the annual reports of the companies listed on the Kuwait Stock Exchange. The secondary data provides various information for the research and for problem solving (Sekaran, 2003). The researcher made use of the internet Netscape Navigator to assist in carrying out the present study and to look through the companies' websites and home pages for their total assets and their profitability.

### **3.4.2 Model Specification and Multiple Regressions**

The multiple regression method is used to examine the relationship between the firm performance in Kuwait stock exchange companies and CEO duality, CEO tenure, audit committee size, board size and board composition.

The result of regression analysis is an equation that represents the best prediction of a dependent variable from several independent variables. This method is used when the independent variables are correlated with one another and with the dependent variable.

The following regression equation is estimated as follow:

$$\text{FIRMPFC} = \alpha_0 + \beta_1 \text{CEODUATY} + \beta_2 \text{CEOTENUR} + \beta_3 \text{AUDITSIZ} + \beta_4 \text{BOADSIZE} + \beta_5 \text{BOADCOM} + \beta_6 \text{FIRMSIZE} + \beta_7 \text{LEVERAGE} + \varepsilon$$

Where:

FIRMPFC – Firm Performance

$\alpha_0$  – Constant

CEODUATY– CEO duality

CEOTENUR – CEO tenure

AUDITSIZ – audit committee size

BOADSIZE –board size

BOADCOM – board composition

FIRMSIZE – Firm Size

LEVERAGE – Leverage

$\varepsilon$  - Error term

For the purpose of examining the relationship between the whole set of predictors and the dependent variable, all dependent variables are entered into the regression equation simultaneously. The objective behind the analysis is the determination of independent variables that are highly significant in determining firm performance.

### **3.4.3 Measurement of the Variables**

This section will provide measurement of dependent variables, independent variables and control variables. The measurements of variables for the study are as follows:

#### **3.4.3.1 Dependent Variables**

One measure regarding firm performance is utilized namely ROA in order to distinguish between the impacts that corporate governance structures have on the types of firm performance. ROA is considered to be the earnings before tax divided by total assets of the company.

#### **3.4.3.2 Independent Variables**

This section will provide measurements of the board characteristics as independent variables which are considered as follows:

**CEODUATY:** is a dummy variable equal to "1" if the CEO is also the chair of the board, and "0" otherwise.

**CEOTENUR:** the period of CEO's serving in the board.

**AUDITSIZ:** the total number of members serving on the audit committee.

**BOADSIZE:** the total number of directors serving on the board of directors.

**BOADCOM:** the board composition is the ratio of outside directors to the total number of directors (I.e. number of outside director's dividend by total number of directors).

### **3.4.3.3 Control Variables**

This section provides firm size and leverage as control variables.

#### **3.4.3.3.1 Firm Size**

Using firm size as the control variable in this study is motivated by the fact that it has been found to be associated with companies with different characteristics. According to, Lehn et al. (2003) they argued that the possibility of firm size and growth are important determinants of the size and structure of the boards. They found that firm size is directly related to size and inversely proportional to the proxy for growth opportunities, that insider representation is inversely proportional to firm size and directly related to the proxy for opportunities growth and thus, a firm size has an effect on the firm performance.

The firm size has an effect on company performance. It is widely used as a control variable in the empirical literature on corporate governance, as in Andres et al. (2005), Yan et al. (2007) and Ghosh (2006). However, firm size can have a clear effect on corporate performance. For example, large firms may be less effective than smaller companies because it can meet most of the government bureaucracy, more redundancy and greater agency problems (Lehn, Patro and Zhao, 2003). However, as they are likely that the use of economies of scale, employ more skilled managers and more powerful on the market, large firms may be more effective (Kyereboah-Coleman and Biekpe, 2005). Similarly, Coles et al. (2001) argued that when firm is growing it needs more board members to help monitor the performance of managers, or it need new directors who have specialized services on board to monitor the growth.

Haniff and Hudaib (2006) measured the dimensions of the natural logarithm of sales (LNSA) and Peng et al. (2007) size measured by natural logarithm of total assets of the company.

Finally, this study will measure firm size by using the natural logarithm of the total firm assets.

#### **3.4.3.3.2 Leverage**

Leverage has been widely used as a control variable by a number of empirical studies that have examined the relationship between corporate governance and financial performance of the company, such as (Kyereboah-Coleman, Biekpe; 2005 and Alsaeed; 2006). These studies have revealed that the debt has an effect on the financial performance of the company. Alsaeed (2006), in his study measures firm leverage by dividing total of liabilities by the total of assets.

The debt ratio is defined as the sum of long-term debt and short-term or extent of liability as a percentage of total assets. It argues that the debt ratio has an effect on all the company's results. On the one hand, a positive effect may result from reduced cash flow, control of the company to expose more of the market. In discussing the agency theory, Jensen and Meckling (1976) argued that the company must leverage to support the monitoring costs such as debt levels increase to agency. Managers are able to provide greater oversight in the most effective boards and committees. Agency theory would predict that the magnitude of the increase in leverage increases the effectiveness of the board. On the other hand, a negative effect of debt can be caused by the failure or the cost of agency fees of debt (Jensen, 1986). Finally, this study will measure leverage by using the dividing total liabilities to total assets. And according to the above, this section will give measurements to the control variables which are as follows:

**FIRMSIZE:** the natural log of total assets.

**LEVERAGE:** the ratio of the ratio of total liabilities to total assets.

**Table 3.2: Research Variables**

VARIABLES	ACRONYM	OPERATIONALISATION
<b>Dependent Variables:</b>		
Return On Assets ratio	ROA	Earnings before tax divided by total assets of the company.
<b>Independent Variables:</b>		
CEO Duality (0/1)	CEODUATY	Dummy variable equal to "1" if the CEO is also the chair of the board, and "0" otherwise
CEO Tenure (year)	CEOTENUR	The period of CEO's serving in the company
Audit Committee Size (number)	AUDITSIZ	Number of members serving on the audit committee
Board Size (number)	BOADSIZE	Total number of directors serving on the board of directors
Board Composition (%)	BOADCOM	The ratio of independence directors to the total number of directors
<b>Control variables:</b>		
Firm Size (number)	FIRMSIZE	The natural log of total assets

Leverage (%)	LEVERAGE	The ratio of total liabilities to total assets
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### **3.5 Data Analysis**

The collected data are analyzed with the use of SPSS 11.5 software which comprises of descriptive statistics that provides details and summary of questions and answers collected from the stock market companies in the Kuwait.

#### **3.5.1 Descriptive Analysis**

The descriptive analysis is carried out to reduce the mean, minimum, maximum as well as standard deviation for each variable of the sample opted for in the present study.

#### **3.5.2 Correlation of Variables**

The present research determines the interrelationships between the variables. The outcome of the analyses displays the nature, direction and significance of the correlation of the variables present in the research and this correlation is analyzed based on the person correlation.

#### **3.5.3 Multiple Linear Regression Analysis**

This study applies multiple linear regressions (MLR) in order to examine the association between the firm performance and board characteristics (CEO duality, CEO tenure, audit committee size, board size and board composition).



### **3.6 Summary of the Chapter**

The present chapter has explained the methodology used in the research and highlighted the hypotheses that have been formulated. In addition, an explanation of the theoretical framework according to the agency theory and hypotheses formulation, research methodology, the research design and data analysis. The next chapter will discuss the findings of this study.

## **CHAPTER FOUR**

### **FINDINGS AND DISCUSSION**

#### **4.1 Introduction**

The present chapter elaborates on the findings of the study through descriptive statistics, correlation analysis and assumptions of multiple regressions. In the final section, results of multiple linear regression analysis will be discussed. For the purpose of the analyses, the Statistical Package for Social Sciences (SPSS) Version 11.5 is applied to the data collected from the annual reports.

#### **4.2 Descriptive Statistics**

The initial step of the analysis of multivariate data comprises a table of means and standard deviations (Genser et al., 2007). With the use of multiple regression analysis, the scores may have a great impact on the results and becomes a cause of concern. Table 4.1 presents the means and standard deviations resulting from SPSS.

**Table 4.1 Summary of Descriptive Statistics**

Variables	N	Minimum	Maximum	Mean	Std. Deviation
CEODUATY	136	0.00	1.00	0.5662	0.49743
CEOTENUR	136	2.00	15.00	7.0000	2.83106
AUDITSIZ	136	0.00	5.00	2.7574	1.22018
BOADSIZE	136	3.00	11.00	6.1618	1.51643
BOADCOM	136	33.33	100.00	74.1160	11.87330
FIRMSIZE	136	3.95	6.78	5.0071	0.60866
LEVERAGE	136	1.48	83.76	40.5358	21.98834
ROA	136	-26.73	19.92	1.0374	8.71350

The table above, (table 4.1) displays the descriptive statistics taken from the present study. The summary reveals that the CEO serves as chairman of the board for 15% of the sample. In other words, the duality of CEO in the sample is considered as low as evidenced by the agency theory which states the importance of the separation of the role of CEO and chair of the board. The mean of the CEO tenure is 7 years with a minimum of 2 and maximum of 15. The mean of the size of the audit committee is 2.8 percent (about 3); this equals the requirement in the MCCG Code which is at least 3 members.

The descriptive statistics of the firms reveal that the mean board size is about 6, which shows that consumer product sector firms in Kuwait possess a relatively moderate board size, having a maximum of 11 members. This means that the board sizes are appropriate for firm's optimum performance as evidenced by Jensen (1993) and Lipton and Lorsch (1992); authors

who stated that the bigger the board size, the less effective it would mean for the firm performance. Moreover, the figures stated are also consistent with those stated by Shakir (2008), Mak and Kusnadi (2005). It can be noticed that the mean of the percentage of independent directors on the board is 74.13, higher than what is necessary in the stock market which states that 33.33 percent of independent directors should comprise a full board.

In addition to that, the mean of the firm size is 5.0071 while the maximum and minimum are 6.7800 and 3.9500 respectively with deviation of 0.6086. Similarly, the mean of the leverage is 40.5358 percentages while the maximum and minimum are 83.76 and 1.48 respectively with deviation of 21.98834.

It is clear that based on the ROA, there is wide deviation between firms. Showing a mean performance of 1.037%, the minimum reported performance over the period is -26.73%, while the maximum ROA is 19.92% with deviation of 8.71350 between firms.

### **4.3 Correlations Analysis**

Correlation analysis is considered as a statistical tool utilized to determine the level by which one variable is related to another (Levin & Rubin, 1998). This analysis marks the initial step in statistical techniques determining the relationship between the dependent and independent variables. Therefore, prior to carrying out a multiple regression analysis, a correlation matrix was developed to analyze the relationships between the independent variables as this would assist in developing a prediction multiple model which will reveal no relationship in cases where the value of correlation is 0. On the other hand, a correlation of  $\pm 1.0$  means there is a perfect positive or negative relationship. The values are interpreted between 0 (no relationship) and 1 (perfect relationship). Also, the relationship is considered small when  $r =$

$\pm 0.1$  to  $\pm 0.29$ , while the relationship is considered medium when  $r = \pm 0.30$  to  $\pm 0.49$ , and when  $r$  is  $\pm 0.50$  and above, the strength is considered to be large. The table below (table 4.2) reveals the correlation between CEO duality, CEO tenure, audit committee size, board size, board composition, firm size and leverage with firm performance (ROA).

**Table 4.2: Correlations of variables**

		CEODU ATY	CEOTENU R	AUDITSIZ	BOADSIZE	BOADCOM	FIRMSIZE	LEVERAG E	ROA
CEODUATY	Pearson	1	0.095	-0.382**	-0.368**	-0.558**	0.005	-0.056	0.093
	Correlation								
	Sig. (2-tailed)		0.271	0.000	0.000	0.000	0.951	0.519	0.281
	N		136	136	136	136	136	136	136
CEOTENUR	Pearson		1	-0.013	0.029	-0.002	0.041	0.031	-0.615**
	Correlation								
	Sig. (2-tailed)			0.881	0.734	0.982	0.639	0.722	0.000
	N			136	136	136	136	136	136
AUDITSIZ	Pearson			1	0.794**	0.520**	0.227**	0.122	0.090
	Correlation								
	Sig. (2-tailed)				0.000	0.000	0.008	0.156	0.299
	N				136	136	136	136	136
BOADSIZE	Pearson				1	0.449**	0.331**	0.174*	-0.028
	Correlation								
	Sig. (2-tailed)					0.000	0.000	0.042	0.746
	N					136	136	136	136
BOADCOM	Pearson					1	0.142	0.073	-0.097
	Correlation								
	Sig. (2-tailed)						0.099	0.399	0.264
	N						136	136	136
FIRMSIZE	Pearson						1	0.467**	-0.042
	Correlation								
	Sig. (2-tailed)							0.000	0.624
	N							136	136
LEVERAGE	Pearson							1	-0.156
	Correlation								
	Sig. (2-tailed)								0.070
	N								136
ROA	Pearson								1
	Correlation								
	Sig. (2-tailed)								
	N								

\*\*. Correlation is significant at the 0.01 level (2-tailed).

\*. Correlation is significant at the 0.05 level (2-tailed).

The above table (4.2) displays correlations between the governance variables and control variables with firm performance. This findings show that CEO duality positively correlated (0.093) with ROA but not a significant level. However, there is a negative correlation between CEO tenure (-0.615) with ROA at 0.000, a significant level.

In addition to that, the correlations between audit committee size is positive (0.090) with ROA but not a significant level. Moreover, board size has no significant correlation but the relation was negative (0.028) between board size and firm financial (ROA). Similarly the correlations between board composition is negative (0.097) with ROA but not a significant level.

Furthermore, the correlations between firm size and firm performance is negative (-0.042) but not a significant level. By contrast, leverage has significant correlation but the relation was negative (0.156) between leverage and firm financial (ROA).

In sum, as evidenced by the above, it can be seen that two variables have a positive correlation with ROA, namely CEO duality, audit committee size. By contrast, five variables have a negative correlation with ROA, namely CEO tenure, board size, board composition, firm size and leverage.

#### **4.4 Multiple Regression**

Multiple regression analysis is a statistical method utilized in order to determine the relationship between one dependent variable and one or more independent variables. Two tests namely assumption of multiple regressions and normality test and also multicollinearity tests will be discussed in the next paragraphs as assumptions of multiple regressions.

#### 4.4.1 Assumption of Multiple Regressions

Prior to carrying out a multiple regression analysis, it is important to note that there are some general assumptions in the undertaking of this analysis. Therefore, in order to test the normality and linearity assumptions of the regression model, a histogram chart plotting the distribution of the residuals were carried out through the utilization of SPSS software program.

#### 4.4.2 Normality Test

Two analyses namely skewness and kurtosis were carried out to test the normality of data distribution. The former analysis displayed normality of data with output values between  $\pm 3$  while the kurtosis analysis also displayed normality with the output values of between  $\pm 10$  (Kline, 1998). Table 4.3 displays the outcome of the two analyses.

**Table 4.3: Normality Tests**

Variables	N	Skewness		Kurtosis	
	statistic	statistic	Std.Error	Statistic	Std.Error
CEODUATY	136	-0.270	0.208	-1.956	0.413
CEOTENUR	136	0.671	0.209	-0.429	0.414
AUDITSIZ	136	-0.665	0.208	0.389	0.413
BOADSIZE	136	0.368	0.208	0.252	0.413
BOADCOM	136	-0.697	0.208	0.352	0.413
FIRMSIZE	136	0.681	0.208	0.565	0.413
LEVERAGE	136	0.059	0.208	-0.883	0.413
ROA	136	-0.677	0.208	0.530	0.413



The table (4.3) shows that the value of skewness is located between the ranges of  $\pm 3$  except the value of ownership which is more than +3. On the other hand, the values of kurtosis lie between  $\pm 10$  including ownership. Therefore, the data of the study includes ownership as it displays normal outcome through kurtosis analysis regardless of the skewness analysis.

#### **4.4.3 Multicollinearity Test**

If the outcome of the multicollinearity test reveals the presence of multicollinearity, in other words, a high correlation between the independent variables, this poses a critical issue in multiple regressions due to the challenges that arise in identifying the effect of one variable upon the dependent variable. Hair et al. (1995) stated that one of the many ways to check for the existence of relationships among independent variables is through multicollinearity test which generally explains the level by which the variable's influence can be determined by the other variable. A popular method of multicollinearity detection and measurement is the utilization of the Variance Inflation Factor (VIF) for each independent variable (Naser, et al., 2002).

In cases whereby the (VIF) is more than 10, the independent variables have high correlations which lead to a multicollinearity problem (Silver, 1997). Hence, the multicollinearity diagnostics with (VIF) was chosen when running the multiple regression models. The outcome revealed in table 4.4 displays the absence of multicollinearity problem as (VIF) for every independent variable resulted in less than 10.

**Table 4.4 Variance Inflation Factor**

Variable	VIF
CEODUATY	1.549
CEOTENUR	1.020
AUDITSIZ	2.986
BOADSIZE	2.968
BOADCOM	1.737
FIRMSIZE	1.441
LEVERAGE	1.289

Dependent variable ROA

#### **4 .5 Multiple Linear Regression Analysis**

The present section will elaborate on the analysis and discussion of relationships, through multiple regression technique, between firm's financial performance (ROA) as dependent variables and independent variables comprising of CEO duality, CEO tenure, audit committee size, board size and board composition and also firm size and leverage as control variable.

The output of multiple regressions shown in Tables 4.5 is related with ROA, as dependent.

**Table 4.5: Summary of the Regressions Model (ROA)**

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	0.678(a)	0.459	0.429	6.49515

A - Predictors: (Constant), CEOTENUR, CEODUATY, AUDITSIZ, BOADSIZE, BOADCOM, FIRMSIZE, LEVERAGE,

B - Dependent Variable: ROA

The outcome is measured by R2 indicating the influence of independent variables on the dependent variables. It is clear that the independent variables determine 45.9% of the ROA variance as displayed in Table 4.5 and according to the R2 of 42.9%, it can be ensured that more than 50% of the relationship with ROA can be determined by the seven independent variables while the remaining 57.1% of the impact to ROA is determined by other factors.

**Table 4.6: The Coefficients of Multiple Regression Analysis**

Model	Coefficients	Std. Error	T	Sig.
(Constant)	16.816	6.420	2.619	0.010
CEODUATY	2.836	1.406	2.018	0.046
CEOTENUR	-1.884	0.200	-9.413	0.000
AUDITSIZ	2.200	0.795	2.769	0.006
BOADSIZE	-0.822	0.636	-1.293	0.198
BOADCOM	-0.084	0.062	-1.349	0.180
FIRMSIZE	0.604	1.103	0.547	0.585
LEVERAGE	-0.052	0.029	-1.801	0.074

Based on the ROA equation stated in Table 4.6, it is noted that if the CEO duality increases by one, then performance of ROA will increase by about 2.836. If the CEO tenure increases

by one, then performance of ROA will decrease by about -1.884. If the audit committee size increases by one, then performance of ROA will increase by about 2.200. If the board size increases by one, then performance of ROA will decrease by about -0.822. If percentage of board composition increases by one unit then the ROA will decrease by about -0.084. If the firm size increases by one, then performance ROA will increase by about 0.604. Finally, if the leverage increases by one, then performance ROA will decrease by about -0.052.

#### **4.6 Discussion**

The regression results on the relationship between ROA and governance variables and control variables are displayed in Table 4.6. The outcome displays mixed results between governance variables, control variables and performance variables. CEO duality displayed a significant positive relation with ROA. This finding supports the first hypothesis that there is a relationship between CEO duality and firm performance. Therefore, the first hypothesis which states there is a relationship between CEO duality and firm performance is supported. This positive value indicates that if and when there is an increase in CEO duality, firm performance (ROA) also increases and vice versa. This result is evidenced by Bhagat & Black (2002), Yermack (1996) who investigated the relationship between CEO duality and firm performance of U.S and Pakistan respectively. They find that there is a positive association between CEO duality and firm performance. The result supports the stewardship theory which states that whenever the CEO also acts as the chairman, the performance of the company increases due to the fact that the owner of the company is relatively familiar and more desirous of raising capital (Williamson 1985).

According to the Table 4.6, the CEO tenure on this occasion has negative impact on ROA and also significant. This finding supports the second hypothesis that there is a relationship

between CEO tenure and firm performance. As a result, the second hypothesis which states there is a relationship between CEO tenure and firm performance is supported. This negative value indicates that if and when there is an increase in CEO tenure, firm performance (ROA) also decreases and vice versa. This result is similar to that found in study Kyereboah-Coleman (2007) and Bertsch & Mann (2005) who investigated the relationship between CEO tenure and firm performance of Ghana and U.S respectively. They find that the negative associated between CEO tenure and firm performance.

By contrast, the audit committee size on this occasion has positive impact on ROA and also significant level. This finding supports the third hypothesis that there is a relationship between audit committee size and firm performance. Consequently, the third hypothesis which states there is a relationship between audit committee size and firm performance is supported. This positive value indicates that if and when there is an increase in audit committee size, firm performance (ROA) also increases and vice versa. This result is similar to that found in a study Mallin (2007), Kajol & Sunday (2008) and Kyereboah-Coleman (2007) who investigated the relationship between audit committee size and firm performance of U.S and Nigeria respectively. They find that there was a positive relationship between audit committee size and firm performance.

As shown in Table 4.6, there is a negative relationship between the board size and firm performance (ROA) but not significant. This finding supports the fourth hypothesis that there is a relationship between board size and firm performance. Accordingly, the fourth hypothesis which states there is a relationship between board size and firm performance is supported. This negative value indicates that if and when there is an increase in board size, firm performance (ROA) also decreases and vice versa. This result is similar to that found in

a study by Lipton and Lorsch (1992), Haniffa & Hudaib (2006), Yermack (1996), Vafeas (2000) and Mak & Yuanto (2003) who investigated the relationship between board size and firm performance in the United States and Malaysia respectively. They find that there was a negative relationship between board size and firm performance.

Similarly, the board composition on this occasion has negative impact on ROA but not significant. This finding supports the fifth hypothesis that there is a relationship between board composition and firm performance. As a result, the fifth hypothesis which states there is a relationship between board composition and firm performance are supported. This negative value indicates that if and when there is an increase in board composition, firm performance (ROA) also decreases and vice versa. This result is similar to that found in study by Haniffa & Hudaib (2006) and Mac Avoy, Dana, Cantor & Peck (1983) and Klein (1998) who investigated the relationship between board composition and firm performance of Malaysia, Singapore and United States. They find that there was a negative relationship between board composition and firm performance.

Furthermore, the size of the company happens to have a positive impact on firm performance (ROA) but not significant. This positive value indicates that if and when there is an increase in firm size, firm performance (ROA) also increases and vice versa. This result is according to Klapper and Love (2003). This finding may lead to reveal an independent source of value creation, probably because of the influence of the market and economies of extent and range (Bohren, 2005).

On the other hand, the debt ratio is the significantly negative effect on the firm performance in Kuwaiti as measured by ROA. This negative value indicates that if and when there is an increase in leverage, firm performance (ROA) also decreases and vice versa. The results

show that the higher the debt ratio, the lower ROA. An inverse relationship between the debt ratio and the performance does not support the body as debt management disciplines. This conclusion is similar to that reported by Bohren (2005), but contrasts with Coleman and Biekpe (2005). This can be explained by the fact that the Kuwaiti financial market is even less effective and may not provide the official position based on the assumption of free cash flow. A further possible explanation is that firms face high debt to increase the cost of operations, as they try to fulfil their obligations to pay interest rates higher.

#### **4.7 Summary**

The present chapter has discussed the results of the analysis that were conducted using various tools. For the purpose of guaranteeing that the data fits the assumptions of multiple regressions, the correlation analysis and regression analysis were both carried out and serious threats in the form of normality and multicollinearity problem were ruled out.

The analyses provided evidence that the relationship between CEO duality and ROA is significantly positive. Therefore, this study found that the relationship between CEO tenure and ROA is negative in the significant level. By contrast, this result found that the relationship between audit committee size with ROA is positive with significant level. In addition to that, the result found that the relationship between board size and board composition is negative but not significant. Furthermore, this result found that the relationship between firm size and ROA is positive but not significant level. Finally, this outcome that the relationship between leverage and ROA is negative with significant level. The table below (Table 4.7) displays the results based on the findings.

**Table 4.7: Summary of the Hypothesis Results**

Hypothesis	Relationship	Findings
H1	Between CEO duality with ROA	Positive & Significant
H2	Between CEO tenure with ROA	Negative & Significant
H3	Between audit committee size with ROA	Positive & Significant
H4	Between board size with ROA	Negative & Insignificant
H5	Between board composition with ROA	Negative & Insignificant



## **CHAPTER FIVE**

### **CONCLUSION**

#### **5.1 Introduction**

This study has tried to find out the relationship between a set of board characteristics (CEO duality, COE tenure, audit committee size, board size, board composition) as the independent variables, firm size and leverage, as the control variable and firm performance (ROA), as the dependent variable, in the 2009 annual reports of listed companies on the Kuwait stock market. The sample of the study is collected from 136 companies listed on the Kuwait stock market in 2009. The first section of this chapter presents the summary of the study followed by a contribution of the study in the second section. Limitations that are inherent in the study are discussed in the third section and the suggestions for the future research are highlighted in the last section.

#### **5.2 Summary of Study**

This study rationally achieved its objective to identify the effect of board characteristics namely, CEO duality, CEO tenure, audit committee size, board size and board composition on the firm performance (ROA) of companies listed on Kuwait's stock market. The study has achieved its basic objective that is to find out the relationship between board characteristics (CEO duality, COE tenure, audit committee size, board size and board composition) and firm performance in the Kuwait listed non-financial firms for the year 2009 and the firm performance (ROA). It should be noted that banks, as well as other financial institutions are excluded from the sample of the study.

With regards to the examination of the impact of board characteristics (CEO duality, CEO tenure, audit committee size, board size and board composition) of the Kuwaiti non-financial firms listed on the Kuwaiti Stock Exchange, upon the firm performance (ROA), an analysis of linear regression is utilized.

The results of the study found that there was significant positive relationship between CEO duality and firm performance. Increase in the combined the role of the chairman and CEO in one person lead to an increase in firm performance in companies listed on the stock market. This consequence is similar with finding in study by Bhagat and Black (2002) and Yermack (1996) who investigated the association between CEO duality and firm performance of U.S and Pakistan respectively. They find that there is positive relationship between CEO duality and firm performance. Moreover, the result supports the stewardship theory which states that whenever the director also acts as the executive director, the performance of the company increases because the owner of the company is relatively familiar and more desirous of raising capital (Williamson, 1985).

In terms of CEO tenure, the results found that there was a significant negative relationship between CEO tenure and firm performance for companies listed on Kuwait's stock market. Increase in the period that CEO sits as manager of the company lead to decrease firm performance. This result is similar to that found in the study by Kyereboah-Coleman (2007) and Bertsch and Mann (2005) who examined the association between CEO tenure and firm performance in Ghana and the U.S respectively. They find that there is the negative association between CEO tenure and firm performance.

Although the results of this study showed that there was positive relationship between audit committee size and firm performance for Kuwait listed companies, this relationship was

statistically not significant. In the same path, this finding was similarly with the study by Mallin (2007), Kajol and Sunday (2008) and Kyereboah-Coleman (2007). Whereas, they said that there was an affirmative association between audit committee size and firm performance. As well as, the study were in U.S and Nigerian respectively.

Board size was the other variable discussed by this study; the results showed that there was a negative relationship between board size and firm performance but the relationship was not significant. The result is same with finding of study in the United States and Malaysia respectively by Lipton and Lorsch (1992), Haniffa & Hudaib (2006), Yermack (1996), Vafeas (2000) and Mak and Yuanto (2003). They studied the relationship between board size and firm performance that the result was a negatively association between board size and performance of the firm.

Similarly, the result of this study showed that there was insignificant negative relationship between board composition and firm performance. This outcome is alike to that discovered in the study by Haniffa and Hudaib (2006), Mac Avoy et al. (1983) and Klein (1998) who examined the relationship between board compassion and firm performance of Malaysia, Singapore and the United States. They found that there was a negative relationship between board composition and firm performance.

In addition to what has been discussed in chapter three, there are two control variables in this study (firm size and leverage), along with the independent variables, to see the effect of these control variables on the firm performance. The regression analysis in table 4.6 showed that firm size is one of the main determinants of the firm performance in Kuwait's firms. The results indicated that firm size was a positive direction but not significantly related to the firm

performance. This consequence was in line with Klapper and Love (2003) and Bohren (2005).

Finally, the regression analysis in table 4.6 showed that leverage is one of the key determinants of the firm performance in Kuwait's firms, and the results showed that there was a significant negative relationship between leverage and firm performance. Increase in Kuwait listed companies leverage lead to decrease firm performance. This finding was similar to that reported by Bohren (2005) who investigated the relationship between leverage and firm performance and found that there was a negative relationship between leverage and firm performance.

### **5.3 Contributions of Study**

This study has enlarged the literature of prior studies that examined the relationship between corporate governance (board characteristics) and firm performance. There are several studies have been done in developed and developing countries (Baysinger & Butler, 1985; Rechner & Dalton, 1991; Coles & Jarrell, 2001; Rhoades et al, 2001; Khatri et.al, 2002; Judge et. al, 2003; Brown & Caylor, 2004; Klapper & Love, 2004; Chen et al, 2005; Haniff & Hudaib, 2006 and Kajol & Sunday, 2008) which examined the relationship between corporate governance (board characteristics) and firm performance. In general, there is a lack of studies that have been done in developing countries and in particular, the Gulf countries.

To my knowledge, there have been no studies done on companies listed on the Kuwait Stock Exchange to investigative the relationship between corporate governance (board characteristics) and firm performance. Hence, this study was carried out under the Kuwait

business environment, different from the other studies which have been performed under different business environment.

This study is one of the studies which is very rare in the developing countries, and hopefully, this study will benefit the owners of companies in Kuwait, in particular, and to all users in general, because this study has shown the relationship between board characteristics and firm performance in Kuwaiti companies. Moreover, this study provides a clear view about board characteristics and firm performance in Kuwait. Adding together, this study makes a positive contribution to improve our knowledge of board characteristics and firm performance. Also, this study provides an interesting literature which might be used in future studies on firm performance.

The findings from the present research undeniably facilitate various points of view that could assist the government, scholars, shareholders, institutional investigations and other relevant stakeholders. Furthermore, this study implies that information derived from nonfinancial corporate governance is more important than that of the overall classification of governance to evaluate the performance of a company. Carefully choosing the companies to improve corporate governance may help investors have a better chance of getting higher portfolio returns.

The results show that good governance of a business is associated with a lower cost of equity and assessment; large investors may be able to reach a better assessment of their activities, eliminating some governance shortcomings such as lack of meetings of the board, the opaqueness of executive compensation, etc. Additionally, the outcome suggests that companies improve their corporate governance performance over time, the change in governance is more important than the level of government in determining the performance

of a company. This finding is useful for companies that listed companies can improve corporate governance over time to improve their operational performance, reduce the problems of free cash flow, low cost of capital and in turn, increases in a firm performance.

Finally, this study reviewed variables discussed by the previous studies which have shown mixed results in the relationship of namely independent variables: CEO duality, CEO tenure, audit committee size, board size and board composition and two control variables firm size and leverage with firm performance. While efficiency of corporate governance characteristics is affected by the environmental that work in, so prior studies did not present evidence to the stakeholders in the other environments where this relationship was not investigated, so this study extended prior studies by provided evidence to Kuwait regulators, owners, managers and government from their environmental about the relationship between these variables with firm performance because corporate governance practice different from country to other depending to culture and other factors.

#### **5.4 Limitation of the Study**

There are several limitations faced this study. The first limitation is related to the research design utilized as the study solely considered companies listed on the Kuwait stock exchange companies with particular emphasis on non-financial companies and hence, overlooking financial as well as non-listed companies. It comes to reasoning that the validation of the outcome might not hold true for financial companies and other non-listed companies and hence, making generalization to all sectors impossible.

The second limitation arranges the sole examination of general suspects who leads to the determination of board effectiveness such as CEO duality, CEO tenure, audit committee size,

board size and board composition and their link to firm performance without examining other corporate governance features such as ownership structures, board and audit committee process and auditor quality. The limitations of this study come from the nature of data collected due to limitations of annual reports, disclosure that were available in Kuwait as compared with the other developed countries.

## **5.5 Future Research**

Future research would be useful to overcome the limitation of this study. Future research can explore financial companies and unlisted companies through the utilization of different methods. The study period of future studies can be extended to other years (panel data) which will hold as a basis for future research and this will lead to covers short and long term effect.

Further studies on the subject can also be extended to entirely different aspects of BOD variables, including its characteristics and explore board processes such as remuneration and nominating committees, board of director's frequency meeting and experience of board of directors. Moreover, future research might be necessary to be conducted in different countries as there are many differences in environments, cultures, level of education, etc. The quality of performance could be studied and observation be made to see whether it is improving over time.

Furthermore, future research should include the other measurements of performance such as Tobin's Q, operating cash flow (OCF), return on equity (ROE) and profit margin (PM). Last of all, the future study that it recommended to study the impact of tax planning on the firm performance among Kuwaiti companies for it has to benefit to examine the relationship

between tax planning and firm performance, whereas tax environment gives a useful to perfect the performance.



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