“BOARD OF DIRECTORS CHARACTERISTICS AND FIRM FINANCIAL PERFORMANCE IN UAE”

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Master of Science (International Accounting)

By

Mohammed Hamood Hamood AL-Mashregy

DECLARATION

I declare that this thesis entitled "Board of Directors Characteristics and Firm Financial Performance in UAE" the substance of this thesis has never been submitted for any degree and is not currently being submitted for any other qualifications.

I certify that any assistance received in preparing this thesis and all sources used have been acknowledged and referenced in this thesis.

Mohammed Hamood Hamood AL-Mashregy

803927

Othman Yeop Abdullah Graduate School of Business (UUM OYA GSB)

University Utara Malaysia

06010 Sintok

Kedah

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Othman Yeop Abdullah
Graduate School of Business

Universiti Utara Malaysia

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Abstract

The purpose of this study is to empirically examine the impact of corporate governance mechanisms (board characteristics) namely; board size, board of director's independence and CEO duality on the firm financial performance (ROA). For the purpose of this study, 60 non-financial listed companies have been chosen; 33 from Abu Dhabi Securities Exchange and 27 from Dubai Financial Market, all in UAE market context. The conduct of testing is controlled by firm size. Multiple regressions analysis is utilized in this study in order to achieve the research objectives. The findings show that factors of board characteristics namely; board size, board of director's independence and CEO duality, have different relations with firm financial performance. First, the finding showed that board size has positive significant impact on the firm financial performance (ROA). Secondly, it showed that the board of director's independence has no significant impact on the firm financial performance (ROA). Moreover, the finding showed that there is negative significant impact of CEO duality on the firm financial performance (ROA). Last but not least, the firm size as control variable has positive significant impact on the firm financial performance (ROA). Therefore, this study can clearly integrate the relationship between corporate governance mechanisms and firm financial performance, and it can help UAE authorities market to improve and enhance the firm financial performance.

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In the name of Allah, the most gracious and most merciful

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CHAPTER ONE

INTRODUCTION

1.1 Background of Study

In the current global business environment, business organizations struggle to achieve high record of growth in order to attract investors to finance their future investment projects. Generally speaking, the investment decisions taken by investors to invest in a particular business are mainly influenced by the ability of the business to remain stable and to generate profits (Mallin, 2007). This justifies the inability of deteriorating businesses to raise funds for their projects. This situation can affect not only the specific business organizations, but also the overall economic performance. To ensure the safety and security of the business environment, governments throughout the world have been paying an increasing attention to the implementation of corporate governance mechanisms. According to the Organization for Economic Cooperation and Development (OECD), "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 fact, many theorists have given an increasing attention to examining the link between corporate governance and the overall organizational performance. Due to its importance to the overall organizational performance, it is considered as one of the major factors that may influence the economic development and expansion. An example of the studies that examined the corporate governance and performance link is the one conducted by Brown and Caylor (2004) that confirmed the positive link between factors such as the composition and characteristics of the members of the board. As widely acknowledged, the main role of the members of the board is to anticipate the future performance of the organization and formulate long-term strategic plans that enhance the overall organizational performance towards achieving its objectives.

To be able to govern the future direction of an organization, CEOs as well as other members of the board of directors pay more attention to the corporate governance mechanisms. In general, corporate governance has been looked at as a set of measures that monitor the processes within an organization to help decision makers to direct the organization to maximize its goal achievement and 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).

For the purpose of measuring the corporate governance, the measure used was categorized into internal and external 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 labor market and mutual monitoring by managers, security analysts, the legal environment, and the role of reputation (Farinha, 2003).

In fact, companies employing effective governance measures are less likely to fall into conflicts that need the intervention of the legal system. In this regard, Klapper and Love (2004) concluded that even though the legal system in which the company operates is not attractive to customers, companies can still provide investors with the needed protection. This, in turn, can attract the investors and enhance the company value and position. In a similar flow of research, Claessens (2003) reviewed the literature related to the corporate governance and identified two ways through which the corporate governance mechanisms can influence the economic performance of a company. First, it can broaden the access to financial resources that enhance the growth and profitability of a company through new project investments. Second, it can help the company to minimize the cost of capital and enhance the overall company value.

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.

The rapid development in UAE business environment and new policies that aim to attract foreign investments to the country, pose challenges to UAE listed companies. Companies have to prepare themselves to face and deal with these challenges in the way that will ensure improvement in its financial performance. One of the mechanisms that would help to improve the firm's financial performance is the board of directors. Theoretically, board of director's characteristics is argued to play a role in influencing the firm's financial performance (Coles, McWilliams & Sen, 2001; Fama & Jensen, 1983; Weir, Laing & McKnight, 2002). So, it is important for UAE companies to benefit

Additionally, in line with the effects the global financial crisis had on countries around the globe, the UAE was not able to entirely avoid the crisis in the latter part of 2008 and 2009 as evidenced by the 2% contraction witnessed in its 2009 GDP, which stood at AED 914.3 billion (USD248.9 billion) (KAMCO Research and UAE Economic Brief and Outlook, 2011).

Table 1-1 Shows the Annual Performance of Market Indicators in UAE

Country	Performance Indicator
Qatar	24.75%
Saudi Arabia	8.15%
Oman	6.06%
UAE (Abu Dhabi)	-0.87%
UAE (Dubai)	-9.60%
Bahrain	-1.78%
Kuwait	-0.71%
USA - S&P 500	12.78%
UK – FTSE 100	9.00%
Hong Kong – Heng Seng	5.32%
Source: GCC stock markets/ bloomberg websites	

Source: GCC stock markets/ Bloomberg websites (2010).

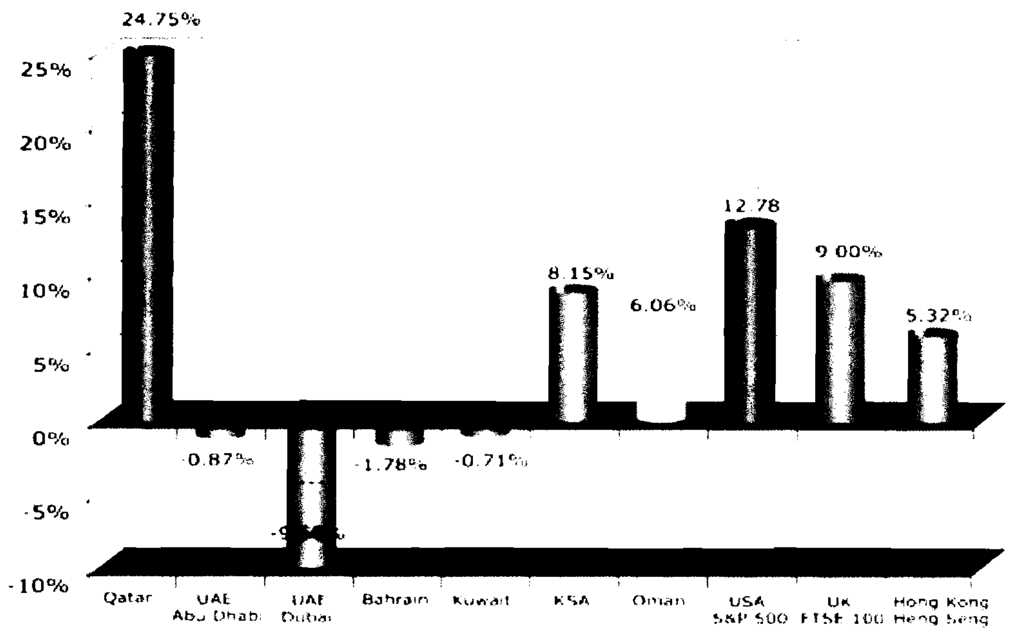

Figure 1-1 Annual Performance of Market Indicators in UAE

Source: GCC stock markets/ Bloomberg websites (2010).

As illustrated in Table 1.1 and Figure 1.1, some of the Gulf economies started to recover from the bad impact of the global financial crisis. However, the UAE market showed lower performance compared to its counterparts in the Gulf region.

1.2 Problem Statement

The importance of corporate governance has been acknowledged by academicians and practitioners particularly regarding the performance of companies in the developed countries. The attention given to corporate governance has been driven by the severe impacts of financial crisis that occurred in different regions of the world due to foreign investors' retraction from some countries causing their collapse. The meltdown in Latin America in 1997 and the East

Asian financial crisis were clear examples that could have been avoided if these countries were excellent in implementing corporate governance mechanisms.

In an attempt to investigate the reasons behind those crises, it has been claimed that the problem was compounded by the absence of corporate mechanisms in the above countries and the ineffectiveness of the institutions. This argument is in line with the premise of the agency theory that assumed that the performance of an organization is greatly influenced by the misuse of authorities given to the management by the stakeholders.

In fact, investors worldwide lost their confidence in investment opportunities especially after the drastic collapse of well-known companies such as Enron crisis in the U.S. in 2001 and the WorldCom in 2002. These crises were partially attributed to the absence of proper corporate governance mechanisms (Becht, Marco & Patrick, 2002). Another example of the absence of corporate governance mechanism and its disastrous effect of overall performance of a company is the Sunbeam in the U.S. in 2001. The former Executive Director of that company was accused in illegal activities involvement with Arthur Anderson causing the company to incur civil penalties that swept away the confidence of investors and stakeholders on the financial system (Rice & Alabama, 2006).

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 financial performance.

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.

To regain the confidence of the investors and encourage the potential business growth, there has been a great emphasis on the corporate governance mechanisms as preventive procedures that secure and provide a clear picture of the economic growth of a company. Various researchers from different fields confirmed the crucial role of corporate governance and its positive effect on the stability and growth of the market environment.Moreover, there has been enormous number of studies that examined its performance implications and confirmed its significant effect on the overall organizational performance (Baysinger & Butler, 1985; Brown & Caylor, 2004; Chen, Elder & Hsieh, 2005; Coles & Jarrell, 2001; Haniff & Hudaib, 2006; Judge, Naoumova & Koutzevol, 2003; Kajol & Sunday, 2008; Khan, Nemati & Iftikhar, 2011; Khatri, Leruth & Piesse, 2002; Klapper & Love, 2004; Rechner & Dalton, 1991; Rhoades, Juleff & Paton, 2001;Yasser, Entebang & Mansor, 2011). On the contrary, some other studies conducted by other researchers (such as Ertugrul & Hegde 2004 ; Kien, Suchard & Jason, 2000) arguing that there is no relationship between corporate governance and firm financial 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 possesses 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 same scenario is applied in the UAE in the context of the study. It was mentioned by the Minister of Economy: Engineer Sultan Bin Saeed Al Mansouri, that, in recent years, UAE economic performances have been affected by the international financial crisis of 2008 (AME, 2009). As shown in the Table 1.2 and Figure 1.2, UAE listed companies have fluctuated by performance based on the ESM index during the period 2001 to 2010 and moreover, their performance declined for the last two years.

Table 1-2 Emirates Security Market Index behavior

Year	ESM Index	Market Value (AED)	Traded Volume (Share)	Traded Value (AED)	No. of Trades	No. of Listed Co.
2001	1,116.68	50,130,930,613	77,253,923	1,515,071,809	19,334	27
2002	1,253.36	109,784,090,882	209,230,202	3,861,378,020	36,341	37
2003	1,657.24	145,631,820,623	561,439,842	7,457,778,820	50,712	44
2004	3,251.57	305,803,235,070	6,069,276,451	66,786,465,772	299,280	53
2005	6,839.97	839,683,136,512	33,811,933,303	509,868,016,048	2,300,452	89
2006	4,031.01	514,697,464,200	50,939,871,239	418,149,306,407	3,138,749	106
2007	6,016.21	824,629,199,856	157,318,141,814	554,333,583,214	3,354,617	120
2008	2,552.23	363,872,030,000	126,439,280,603	537,134,415,081	3,257,450	130
2009	2,771.56	404,702,613,093	148,297,352,509	243,489,889,472	2,728,964	133
2010	2,655.32	385,429,934,198	56,003,360,875	103,804,933,675	1,158,505	129

Source: GCC stock markets/ bloomberg websites (2010).

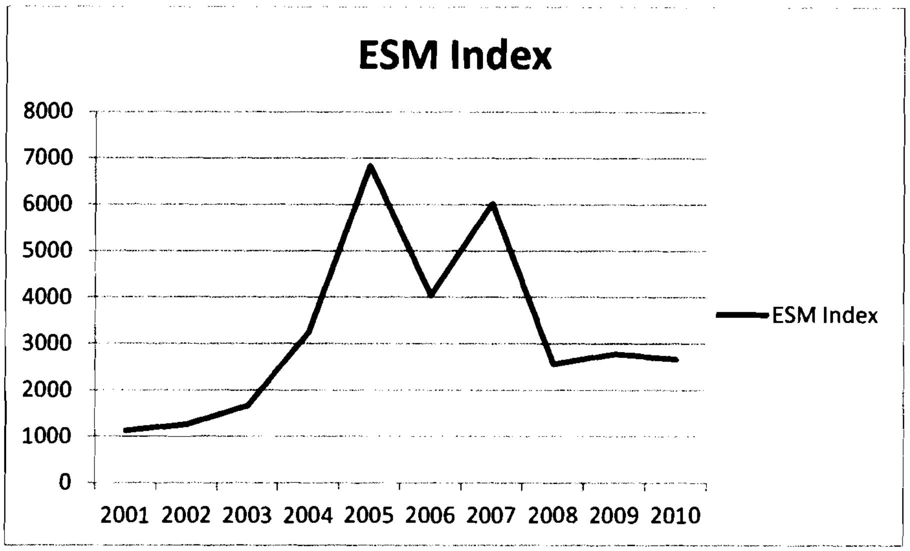

Figure 1-2 Emirates Security Market Index

Source: GCC stock markets/ bloomberg websites (2010).

In explaining the major cause of financial crisis in the UAE, Dr Nasser Saidi, Chief Economist of the DIFC stressed that the major contribution was attributed to the lack of corporate governance (AME, 2010).

Based on that situation, Adawi and Rwegasira (2010) carried out a study regarding the corporate governance in UAE by using the data of 2007. Their study reflected the state of corporate governance practices, in the listed companies that is enforced in 2010, prior to the issuance of the UAE Corporate Governance Code. They, however, recommended that further research should be conducted to use the period after implementation of the corporate governance code in 2010 when studying the effect of corporate governance on the firm financial performance.

As an attempt to further examine the efficiency of the corporate governance in enhancing the financial performance of the firm, this study examines the effect of board characteristics (board size, board of directors' independence and CEO duality) on firm financial performance of UAE listed companies based on the 2010 data.

1.3 Research Questions

In general, this study aims to provide additional insights into the relationship between board size, board of director's independence and CEO duality as independent variables and firm financial performance in UAE. Specifically, the following research questions would be addressed in this study:

1. Does the size of the board directors influence the firm financial performance?
2. Does board of director's independence influence the firm financial performance?
3. Does CEO duality influence the firm financial performance?

1.4 Research Objectives

In order to examine the impact of corporate governance mechanisms (board characteristics) namely (board size, board of director's independence and CEO duality) in the context of firm financial performance (ROA), the following are the objectives of the study:

1) To investigate the influence of the size board of the director on firm financial performance.
2) To determine the influence of board of director's independence on firm financial performance.
3) To examine the influence of CEO duality on firm financial performance.

1.5 Significance of Study

The significance of the study can be seen both from theoretical and practical perspectives. From a theoretical perspective, this study supported agency theory regarding the effect of board of director's characteristic on firm financial performance. Several studies have been conducted in the developed countries (Gompers, Ishii & Metrick, 2003; Kang & Zardkoohi, 2005; Klapper & Love, 2004) and developing countries (Ahmadu, Aminu & Taker, 2005; Limpaphayom & Connelly, 2006) which examined the relationship between corporate governance mechanisms and firm financial performance, but there are still a number of countries that have not been tapped to examine the relationship between corporate governance and financial performance. To the researcher's knowledge, there is a lack of research examining the relationship between corporate governance mechanisms (i.e., board of directors' characteristics) and firm financial performance of companies listed on the UAE Stock Exchange. Moreover, this study is conducted under the UAE business environment, unlike the other studies that have been conducted under different business environments. So the practical contribution will be provided from the findings of this study which will be useful to many sectors such as regulators, investors, companies and even to employers.

1.6 Scope of study

There are some aspects that have to be considered in the scope of this study. The study will use only data of the year 2010. The study will examine the board of director characteristics (board size, board of directors' independence and CEO duality) and its relationship to firm financial performance, which is measure by ROA.

1.6. Definition of Terms

For the aims of this research study, the following terms are used:

1.6.1 Firm financial performance (RAO)

ROA was defined by Leuz and Verrecchia (2000) and Xiao, Yang, and Chow (2004), to be the ratio between the net income and the total assets of the firm. However, it is used to measure the profitability or the financial performance of the firm.

1.6.2 Corporate Governance

"Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring" (OECD, 2004; p.18).

1.6.3 Board's Independence

It is the presence of non executive directors in the board. The presence of more independent directors on the board will make the board more independent. An independent board will be better placed to make independent decisions and hence safe guard the interests of all the stake holders, particularly the rights of minority shareholders (Khan et al. 2011).

1.6.4 CEO Duality

It is whether a firm has different persons appointed as CEO and Chairman or the same person assumes both the positions (Khan et al. 2011).

1.6.5 Agency Theory

Agency theory has been defined as "a contract under which one or more persons (the principal[s]) engage another person (the agent) to perform some service on their behalf, which involves delegating some decision-making authority to the agent" (Jensen & Meckling, 1976; p. 308).

1.7 Organization of the Study

This study is organized into five chapters. The first chapter contains the background of the study, problem statement, research questions, research objectives, significance of study, scope of study, definition of terms and organization of the remaining chapters.

The next chapter, chapter two, contains the literature review and prior research that are related to this study. The review presented in this chapter includes the overview of firm financial performance, corporate governance (board characteristics) and firm financial performance, and finally the summary of the chapter.

Furthermore, the third chapter describes the research methodology, research framework, hypotheses development, research design, data collection, operational definition and measurement of the variables, and method of data analysis.

The fourth chapter deals with analysis; the chapter provides the reader with data analysis, which includes descriptive statistics, correlation analysis, multiple regressions, multiple linear regression analysis, discussions of the results and finally, the last section discusses the summary of the chapter.

Chapter five discusses the overall findings and concludes the research. The chapter presents the summary of the study, implication, limitation and recommendation for future research.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This section reviews literatures related to empirical findings from past studies on board of directors and firm financial performance. A comprehensive search of the literature reveals that several studies have been undertaken to examine the relationship between boards of directors' characteristics and firm's performance. Overall, the chapter covers previous research related to board of directors' characteristics, namely board size, board independence and CEO duality and financial performance.

2.2 Overview of Firm Financial Performance in UAE

Based on the pervious discussion in chapter1 which shows there is an increase in the performance of ESM Index from 2001 until 2005 but after that, there was instability in the performance from 2006 into 2010 due to the impact of the financial crisis of 2008. It is also discussed the most of the international and Gulf markets have started recovering from the global financial crisis impact, particularly the markets controlled directly or indirectly by their governments. In comparison with other Gulf countries, the performance of UAE markets was the lowest in 2010.

2.3 Firm Financial Performance

2.3.1 ROA

According to Iswatia and Anshoria (2007) performance is the function of the ability of an organization to gain and manage the resources in several different ways to develop competitive advantage. There are typically three broad categories of performance: financial performance, operational performance and organizational effectiveness (Thomas, 2007). Duncan and Elliott (2004) argue that there are two principal paths to improve financial performance for financial institutions that is through improved operational efficiency or via improved customer service. Haniffa and Hudaib (2006) argue that corporate performance is presumably reflected in the way the firm is managed as well as the efficacy of the firm's governance structure. Similarly, Abdullah (2004) argues that the firm's value is predicted to increase and the wealth of the shareholders will be enhanced accordingly, if the board performs its duties effectively. In addition, Beiner, Drobetz, Schmid and Zimmermann (2004) argue that firm financial performance is both a result of the actions of previous directors and factors that influence the choice of subsequent directors.

There are many methods to measure financial performance such as the level of profitability, earning after taxes, residual income, return on assets, return on earning, return on investment, economic value added, etc. Many of these measures have been used in governance studies to measure financial performance. Bhagat and Black (2001) for example, assessed firm financial performance using Tobin's Q, return on assets, ratio of sales to assets and market-adjusted stock price returns. Ahmadu et al. (2005) use returns on assets, return on equity and Tobin Q. Limpaphayom and Connelly (2006) use return on assets and return on investment. Mustafa (2006) use return on assets and market book value and the Tobin's Q. Krivogorsky (2006) use return on assets, return on equity and market –to- book value and Lefort and Urzúa (2008) use Tobin's Q, return on assets and market –to- book value.

The dependent variable in this study is the firm's financial performance that is defined as financial performance indicators which in this study are considered as the return on asset (ROA). According to Haniffa and Huduib (2006) a higher ROA indicates effective use of companies' assets in serving shareholders' economic interests. ROA varies widely among companies and is a measure of asset-use efficiency. It can be used as a useful indicator for comparing the profitability of company and businesses against a benchmark rate of return equal to the risk adjusted weighted average cost of capital. It also measures the operating and financial performance (Klapper & Love, 2004). ROA provides a measure for assessing the overall efficiency with which firm assets are used to produce net income from operations (Miller, Michael & Craig, 2001). Moreover, they argue that the ROA is indicative of management's effectiveness in deploying capital because it is certainly possible to be efficient and yet poorly positioned in terms of how capital is being utilized.

Moreover, Khan et al. (2011) highlighted the strong and positive influence of corporate governance namely (ownership concentration, CEO duality and Board's Independence) on firm's performance. The results and findings are considered as empirical evidence to highlight and support the relationship between independent variables and independent variables that are the highlights of the study. Furthermore, the results will support the current study in many perspectives.

Finally, ROA has been used widely in corporate governance studies such as, Ahmadu et al. 2005; Bebczuk, 2005; Krivogorsky, 2006; Lefort & Urzúa, 2008 ; and Limpaphayom & Connelly 2006.

2.4 Board of Directors Characteristics

Board of directors is one of the important elements used in internal corporate governance mechanisms. According to Lefort and Urzúa (2008), board of directors is a central institution in the internal governance of a company which provides a key monitoring function in dealing with agency problems inherent in managing an organization (Hermalin & Weisbach, 2003). Fama and Jensen (1983) argue that by exercising its power to monitor and control management, the board of directors can reduce agency conflicts based on the perception that managers may have their own preferences and may not always act on behalf of the shareholders and thus, board of directors should monitor them (Limpaphayom & Connelly, 2006). In addition, board of directors, as internal corporate governance mechanisms, will have a direct impact in assuring adequate returns for shareholders (Weir et al. 2002). One of the board of director's duties is to optimize shareholder value (Coles et al. 2001).

The impact of board of directors on companies' financial performance depends on board effectiveness. The board effectiveness relies on two main issues, in which Abdullah (2004) and Fama and Jensen (1983) argued that board independence and its leadership structure are important characteristics of the board that determine its effectiveness. The board characteristics namely board size, board independent, and director's duality will be reviewed in the following sections.

2.4.1 Board Size

Board size or the number of directors on board is an important factor in the effectiveness of the board. Increase in board size would improve companies' board effectiveness to support the management in reducing agency cost resulting from poor management and would lead to better financial results (Jensen & Meckling, 1976). According to Kyereboah-Coleman and Biekpe (2005) larger boards are better for corporate performance because they have more capabilities and expertise in assisting the management in decision makings and are harder for a powerful CEO to dominate. This results in improving governance, especially in enhancing company's management and financial performance. Dalton and Dalton (2005) argue that in addition to providing access to exponential resources and networking opportunities, larger boards have added benefit to expand the number of individuals on whom the CEO and other executives can rely on for sources of advice and counsel. Larger boards also provide opportunities to broadly enhance the diversity of the board, including experience, skill sets, gender and race.

However, Jensen (1993) argues that having a larger board of directors in the corporation leads to be less effective as it presents a hard mission for CEO to control. Moreover, he argues that once the board gets too big, it becomes difficult to co-ordinate and process problems. On the other hand, smaller boards reduce the possibility of free riding by individual directors, and increase their decision making processes. According to De Andres et al. (2005) the benefits of better management control by the larger board of directors are offset by the potential disadvantages from coordination, communication, and decision making problems. This argument has been supported by Hermalin and Wiesbach's (2003) study which revealed that smaller board size leads to better performance.

Although many studies have examined the association between board size and financial performance, there is no consistency in this relationship. Some of these studies indicate a positive relationship between the board size and financial performance (Dalton & Dalton, 2005) while some studies find a negative relationship between board size and firm's financial performance (Ahmadu et al. 2005; Hermalin & Wiesbach, 2003; Ghosh & Sirmans, 2005; Limpaphayom & Connelly, 2006; Mustafa, 2006). De Andres et al. (2005) found that companies with oversized boards of directors have poorer performance both in countries where internal mechanisms of governance dominate and in countries where external mechanisms are predominant. They indicate that the underlying rationality on the effect of large board on the performance can result in poorer communication and coordination inside the board. Similarly, they found significant negative relationship between the board size and firm financial performance.

Other studies such as Beiner et al. (2004) find no significant relationship between board size and firm valuation, as measured by Tobin's Q. Similarly, Bhagat and Black (2001) also find no consistent correlation between board size and firm financial performance when using sample of the largest United States firms.

Finally, for additional evidence, there is a positive significant relationship between ROA and PM and three corporate governance mechanisms (board size, board composition and audit committee) as provided by a study of corporate governance and firm performance in Pakistan (Yasser et al. 2011).

These findings are related to the validity of the aim of the case under study.

2.4.2 Independence of Board of Directors

Board independence or the degree to board members are dependent on organization is seen as a primary incentive that is key to board monitoring. Fama and Jensen (1983) suggest that the board's effectiveness in monitoring management is a function of the combination of insiders and outsiders who serve on the board. Christopher (2005) suggests that independent directors on the board add value to an organization by increasing responsibility, by providing self-governing judgment, by increasing the network of business connections for the board and executive, and by moderating the power of the chair and/or CEO which in some organizations, may be overly powerful. As a result of their independence from firm management, the non-executive or outside directors are believed to provide superior benefits to the firm (Judge et al. 2003). Similarly, Roberts, McNulty and Stiles (2005) note that if an outside director is an active participant, the independence of mind such a director brings to the team can be a valuable contribution to the functioning executives in their leadership of the business, and in monitoring and controlling executive conduct. Moreover, they argue that the non-executives can support both the non-executives acting individually and collectively and thus, are able to create accountability within the board in relation to both strategy and performance.

Many empirical studies have been conducted in recent years on whether there is any link between independent directors on the board and corporate performance. Some researchers have looked for direct evidence of a link between board composition and corporate performance. Krivogorsky (2006) in his study found strong positive relation between the portion of independent directors on the board and firms profitability ratios. Empirical evidence by Lefort and Urzúa (2008) also found proportion of outside directors to be positive and significantly correlated with firm's financial performance which was measured by Tobin's Q. Similarly, Limpaphayom and Connelly (2006) found a positive relationship between the board composition and firm profitability ratio.

On the other hand, Erickson, Park, Reising and Shin (2005) found a negative relationship between greater board independence and firm value in their study, which aimed to examine the relationship between the board composition and firm value in the presence of significant ownership concentration on using publicly traded Canadian firms over the 1993–1997 period. Moreover, they found that poorly performing firms increase the proportion of outside director in subsequent periods. They suggested that the presence of outside directors who are officers of financial institutions had increased the firm's value.

Few researches (Chin, Vos & Casey, 2004; Fosberg, 1989; Klein, Shapiro & Young, 2005) do not show any relationship between the presence of non-executive directors on the board and firm performance.However, there are also a number of researches that do not show any improvement in the performance due to outside directors of the board, for instance, (Bhagat & Black, 2001; De Andres et al. 2005) found no significant relationship between the composition of the board and the value of the firm. Bhagat and Black (2001) also provided evidence that low-profitability firms respond to their business troubles by following conventional wisdom and increasing the proportion of independent directors on their board.

2.4.3. CEO Duality

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 are also the chair of the board. According to Carapeto, Lasfer and Machera (2005) a company can achieve superior performance when the CEO exercises complete authority and his role is both unambiguous and unchallenged. However, Fama and Jensen (1983) and Jensen (1993) argued that the separation between the CEO's roles and chairman (COB) facilitates the reduction of the agency costs and increases the firm financial performance. Moreover, they argue that duality decreases firm financial performance and increases the agency problems due to CEO entrenchment and a decline in board independence from corporate management. These arguments have been supported by Yermack (1996) study which found that firms are more valuable when the CEO and board chair positions are separate.

The literature investigating the impact of the CEO/chair duality on firm financial performance has produced mixed results. Some studies find significant negative relationship between CEO duality and firm financial performance (Ahmadu et al. 2005; Judge et al. 2003; Mustafa, 2006) The results of these studies have been supported by (Feng, Ghosh & Sirmans, 2005). study that found a negative relationship between firm financial performance (measured by ROA, ROE and Market-to-book ratio) and CEO duality. All these studies suggest that managerial entrenchment in the form of CEO duality is associated with lower firm value. Kyereboah-Coleman and Biekpe (2005) examine the relationship between CEO duality and performance measures namely ROA, Tobin’s Q and Growth in sales of non-financial listed firms on the Ghana Stock Exchange. They find the separation of board chairman and chief executive officer positions minimizes the tension between managers and board members thus positively influencing the performance of firms in Ghana.

There are many researches which do not show any change of performance due to CEO duality. Schmid and Zimmermann (2007) find no evidence of a systematic and significant difference in firm's value between firms with combined functions and firms with separated ones. Moreover, they find a similar curvilinear relationship between leadership structure and managerial shareholdings as between Tobin's Q and managerial share-holdings. They indicate that agency costs associated with a combined function are mitigated by a higher incentive alignment of the CEO/chairman through an adequate level of managerial share-holdings. Similarly, Wan and Ong (2005) find no relationship between the CEO duality and financial performance.

Carapeto et al. (2005) conducted a study to assess whether the decision to split and to combine the roles of CEO and COB creates value. The study found that the decision to split (combine) the role is greeted with significant positive (negative) abnormal returns and these abnormal returns are strongly related to various measures of agency costs. However, the study did not find strong performance (underperformance) of companies that split (combine) the roles in the post-event period. The authors suggest that contrary to the market's expectations, the split/combination of the roles of the CEO and the COB does not actually mitigate or exacerbate the agency conflicts.

Kang and Zardkoohi (2005) reviewed a number of studies that examined the relationship between CEO/chair duality and various organizational measures. They found that the results of previous studies are mixed. Therefore, they concluded that the impact of CEO/chair duality is complex and may, to a large extent, be dependent upon the reasons for the duality existing in the first place. They suggested for instance, that if the dual role is assigned as a reward for the CEO, then one might expect a positive relationship between the duality and organizational performance.

However, if the dual role had been assigned as a result of consolidation of the CEO's power, then one might expect the associated agency problems to lead to a negative impact on organizational performance.

2.5 Agency Theory

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

According to the agency view, the delegation of administrative responsibilities, which are usually provided to school administrators and agents, are 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 to result in the highest possible returns. Consistent with Kyereboah-Coleman and Biekpe (2005) it is found that the agency theory arranges the relationship between corporate governance and firm financial 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 and crucial mechanisms that provide the monitoring function and mitigating the agency problem is the board of directors (Lefort & Urzua, 2008). Arguably, the board of directors plays 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 its ensure that meet 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 (Coles et al. 2001;Fama & Jensen,1983). Prior empirical studies reveal that the relationship between board size, board independence and CEO duality and firm performance are mixed results (Baysinger and Butler, 1985; Brown and Caylor, 2004; Chen et al, 2005; Coles et al. 2001; Hudaib and Haniff, 2006; Judge et al. 2003; Kajol & Sunday, 2008; Khatri et.al. 2002; Klapper and Love, 2004; Kyereboah- Colemn & Biekpe, 2005; Rechner and Dalton, 1989). It is worth to mention that all of the extant research has been conducted in different settings other that exist in UAE. To the best of our knowledge, no empirical study exists that provides a conclusive determination of the variables influencing the performance of companies incorporating in UAE.

The present study attempts to investigate the relationship between the board of directors' characteristics comprising of board size, board independence and CEO duality with firm financial performance (ROA) of companies listed on UAE stock exchange. These named board characteristics are considered as the independent variables, and they will be examine against the firm's performance (i.e. ROA) which represents the dependent variable.

2.6 Summaries of Literature Review

Table 2-1 Summary of Some Previous Studies

Author	Location and Sample Used	Variables Used	Analysis Used	Result
Khan, Nemati & Iftikhar, (2011)	Pakistan data from three listed companies of the Tobacco industry, namely Pakistan Tobacco, Lakson Tobacco and Khyber Tobacco have been used based on a five year period- 2004-2008	ownership concentration, CEO duality and Board's Independence and Firm's performance (ROA)	Regression analysis.	Strong and positive impact of corporate governance on firm's performance has been seen.

Azofra & Lopez (2005)	USA 450 non-financial firms from ten countries in Western Europe and North America.	Board size – board composition and firm value.	Regression analysis.	It was found that (1) there is a negative relationship between firm value and board size (2) no significant relationship exists between the composition of the board and the value of the firm.
Krivogorsy (2006)	USA 87 companies from nine European countries (foreign U.S. registrants).	Board composition ownership concentration, and firm profitability (ROA).	Regression analysis.	Strong positive relations between the level of relational-investors ownership (%INST) and profitability ratios, as well as a strong, positive relation between the portion of independent directors on the board and profitability ratios were detected, but no strong relation between the portion of inside directors or level of managerial ownership and profitability in European companies.
Mustafa (2006)	Egypt 85 non- financial Egyptian firms.	Board size CEO duality, Large shareholders and firm performance (ROA).	Stepwise regression analysis.	Positive effect of large shareholdings on financial performance. However, significant negative effect of board size and CEO duality on financial performance.
Ahmadu et al., (2005)	Nigerian 93 firms listed in Nigerian stock exchange.	Board size, CEO duality, Outside directors, Ownership concentration and firm performance (ROA)	OLS regression.	Positive effect of large shareholdings on financial performance. Significant negative effect CEO duality on financial performance. Their results support the need to maintain a board size of ten persons.

Lefort & Urzúa (2008)	Chile, using a four-year, 160-companies panel data.	Board composition and companies' value.	3SLS regression.	The result is that only the proportion of outside directors is positive and significantly correlated with Tobin's Q.
Limpaphayom & Connelly (2006)	Thailand, 24 life insurance firms operating in Thailand.	Board size – board composition, and firm performance (ROA).	Regression analysis.	Board composition has a positive relation to profitability and a negative relation with the risk-taking behavior of life insurance firms. Board size does not have any relation with firm performance.
Kyereboh Coleman &Biekpe (2005)	Ghana 16 listed non-financial firms on the Ghana Stock Exchange.	Board size – board composition, CEO duality, and firm performance (ROA).	Regression analysis.	The study found that board size is positively related to Tobin's Q and ROA, but negatively related to sales growth rate. However, it was found that board composition and CEO duality have a negative impact on firms' performance in Ghana.

2.7 Chapter Summary

From the previous studies that have examined the relationship between boards' characteristics and firm's performance, it can be concluded that there is no consensus between researchers about the direction of the relationship between board size, independence of board director and CEO duality and financial performance. Some characteristics of the board indicate a positive relationship with performance, but quite a number of studies resulted in negative relationships. Due to lack of the previous research, this study will examine the relationship between three key characteristics of the board and firm financial performance indicators in the new environment. The following chapter will discuss the hypothesis development and research methodology.

CHAPTER THREE

RESEARCH FRAMEWORK METHODOLOGY

3.1 Introduction

The previous chapter has reviewed prior studies that have been conducted in different countries to examine the relationship between the board of directors' characteristics and financial performance. This chapter is divided into three sections which are: (1) Research framework to verify the relationship between the board of directors' characteristics (i.e. board size, independence of board of directors and CEO duality) and financial performance (ROA), (2) Hypotheses development and (3) Research methodology.

3.2 Research Framework

The independent variables of this study are the board size, independent board of directors and CEO duality. The dependent variable in this study is firm financial performance and is measured by ROA. Figure 3.1 below shows the research framework of the study.

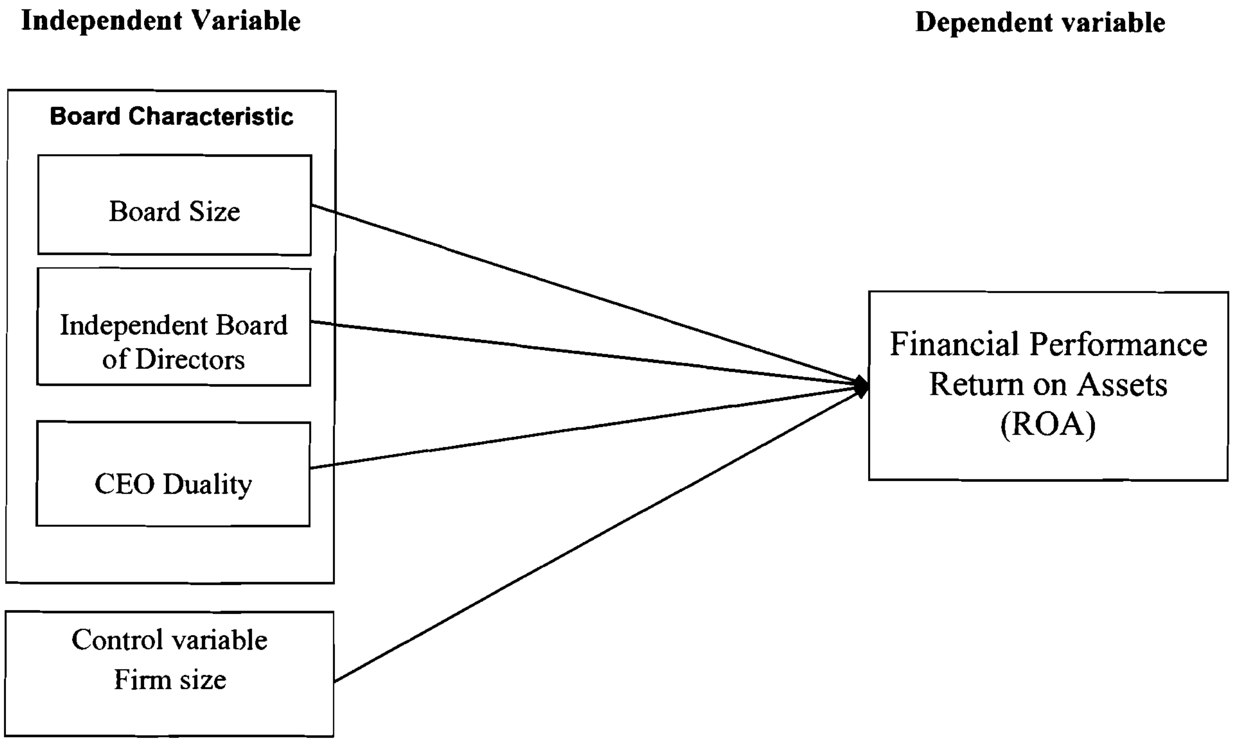

Figure 3-1 Theoretical Framework

The theoretical framework upon which this study is based is the agency theory. According to Kyereboah-Coleman and Biekpe (2005) the notion behind the researches that examine the relationship between corporate governance with firm financial performance comes from the agency theory. This theory is concerned that the interests of owners and managers may not match (Jensen & Meckling, 1976).

The agency perspective asserts that the delegation of managerial responsibilities that is given by principals (owners) to their agents (managers) requires using of mechanisms that either align the interests of principals and agents or monitors the performance of managers to ensure that they use their delegated powers to generate the highest possible returns for the principals. One of these mechanisms that provide a key monitoring function in dealing with agency problems is boards of directors (Lefort & Urzúa, 2008). The board of directors is argued to play an important role in protecting the interests of various stakeholders against management's self-interests. According to Hermalin and Weisbach (2003) one of the optimal solutions to some agency problems which modern companies face is the board of directors. Furthermore, Fama and Jensen (1983) argued that the board of directors is needed to minimize agency cost and maximize shareholder interests. Enhancement in board of director, in term of board size, board composition and leadership structure, could improve board effectiveness and its capacity to monitor management (De Andres et al. 2005; Abdullah, 2004).

Theoretically, the characteristics of the board have been argued to play a role in influencing firm performance (Coles et al. 2001; Fama & Jensen 1983; Weir et al. 2002). Empirically, the result of previous studies regarding the relationship of the board characteristics, namely board size, board's independent and CEO duality with performance have been reported as mixed (Ahmadu et al. 2005; De Andres et al. 2005; Krivogorsky, 2006; Kyereboah- Colemn & Biekpe, 2005; Lefort & Urzúa, 2008; Limpaphayom & Connelly 2006). Therefore, this study specifically investigates the relationship between the board characteristics, namely board size, boards independent and CEO duality and firm's financial performance (ROA).

3.3 Hypotheses Development

3.3.1 Board Size and Firm Financial Performance

Commonly, board size has been argued to affect the monitoring ability and larger boards are often believed to be more able to monitor the actions of top management (Abdullah, 2004). However, Lipton and Lorsch (1992) argued that as board size increases, boards might become less effective at monitoring management. They recommend board membership should be between eight and nine, and any additional benefits that can be gained from increased monitoring by additional membership will offset the costs linked with slow decision making, effort problem and easier control by the CEO. They measured firm financial performance by Tobin's Q, ROE and ROA measurement. This view has been supported by Jensen (1993) who indicated that the board of directors became less efficient when the number of the board members is over 7 or 8. Empirical evidence on the relationship between board size and firm's financial performance provided mixed results. Dalton and Dalton (2005) and Yasser et al. (2011) found a positive relationship between board size and financial performance. While, Ahmadu et al. (2005), De Andres et al. (2005), Mustafa (2006) and Yermack (1996) found larger boards to be associated with poorer performance. On the other hand, Beiner et al. (2003), Bhagat and Black (2001) and Limpaphayom and Connelly (2006) found no significant association between board size and financial performance. Due to the inconsistent and mixed results, there is an urgent call for further investigation. Therefore, this study responds to the call by examining the relationship between board size and firm financial performance. It can be hypothesized as follow:

H1: There is a significant relationship between board size and firm financial performance.

3.3.2 Board Independence and Financial Performance

Boards of directors consist of inside and outside directors. Outside directors are persons who serve on the board of a firm but do not act in any sort of executive capacity. According to Jensen and Meckling (1976), boards dominated by outsiders or non-executive directors (NEDs) may help to mitigate the agency problem by monitoring and controlling the opportunistic behavior of management. Baysinger and Butler (1985) argued that outside directors provide superior performance benefits to the firm as a result of their independence from firm management which is an important characteristic of board that determines its effectiveness in monitoring management (Fama & Jensen, 1983).

The results of previous studies that investigated the relationship between the independence of directors and firm financial performance are inconsistent. Krivogorsky (2006), Lefort and Urzua (2008), Limpaphayom and Connelly (2006) found positive relationship between the portion of independent directors on the board and firm's financial performance. On the other hand, Erickson et al. (2005) found negative relationship between greater board independence and firm value. However, Bhagat and Black (2001) and De Andres et al. (2005) found no significant relationship between the composition of the board and the value of the firm. Based on the arguments regarding board independence, this study leads to the following alternative hypothesis:

H.2: There is a significant relationship between independence directors of boards and firm financial performance.

3.3.3 CEO Duality and Firm Financial Performance

Duality occurs when the same person undertakes both of the roles of CEO and chairman (Fama &Jensen, 1983). Furthermore, Jensen and Meckling (1976) argued that someone who holds two top positions is more likely to follow strategies which advance his/her personal interests to the harm of the firm as a whole. Similarly, Mallette and Fowler (1992) argued that in combined roles, the chairman of the board must make decisions potentially leading to a conflict of interest. Moreover, in combined roles, the CEO can set the board's agenda and can influence the selection of directors for the board. They concluded in their paper that CEO duality can challenge a board's ability to monitor executives. According to Rechner and Dalton (1991) to facilitate more effective monitoring and control of the CEO, agency theory suggests splitting the board chair position from CEO position. Moreover they argued that firms that fail to do so may underperform those which split the two top positions. These views has been supported by Jensen (1993) who argues that separating the CEO and chairman positions is important for ensuring the board's effectiveness which leads to increase in the firm value (Yermack, 1996). However, empirical analyses of the impact of duality on various corporate performance measures have yielded conflicting results. Ahmadu et al. (2005), Feng et al. (2005), Judge et al. (2003.) and Mustafa (2006) found a negative significant relationship between CEO duality and firm financial performance. In contrast, (Carapeto et al. 2005; Schmid & Zimmermann, 2007; Wan & Ong, 2005) found no significant difference in the performance of companies with or without role duality. Kyereboah- Colemn and Biekpe (2005) found that firms with a separation of the two roles consistently have higher accounting returns compared to those that have the roles combined. Based on the above discussion, this study leads to following hypothesis:

H.3: There is a significant relationship between CEO duality and firm financial performance.

3.4 Research Methodology

3.4.1 Data Collection

In this study, the sample consists of non- financial firms that are listed on Abu Dhabi Securities Exchange (ADX) and Dubai Financial Market (DFM) (www.adx.ae/default.aspx, www.dfm.ae/default.aspx) in the year 2010. According to ADX and DFM, there are 60 companies, 33 companies in ADX and 27 companies, in DFM. Due to the differences in the regulatory requirements, and the characteristics of their financial reports which are different from those of non-financial firms, the banks and the other financial institutions are excluded in this study (Alsaeed, 2006). So, the year 2010 is chosen in this study for non-financial firms. The year's annual reports formed the latest source of information available at the time the study was initially conducted. Thus, this study relied on secondary data

3.4.2 Data Collection Procedures

The procedure of data collection in this study is based on secondary data retrieved from annual reports of the year 2010. In order to answer the research questions, the annual reports of UAE listed company exclusively gathered from ADX and DFM have been used. Seeking for secondary data saves costs and time for obtaining information. These sources of secondary data provide a lot of information for research and problem solving (Sekaran, 2003). Data stream is also used to collect the financial data, mainly return on assets (ROA), total assets, and total debt to total asset.

3.6 Operational Definition and Measurement of the Variables

3.6.1 Dependent Variable

The dependent variable of this study is firm financial performance. To investigate the effect of board characteristics on firm financial performance empirically, it is important to have appropriate performance measurements in order to get an objective analysis. Many studies have traditionally used various financial measurements in order to examine the role of boards such as return on assets (Kiel & Nicholson, 2003),Tobin's Q or its proxy used by some researchers (Kiel & Nicholson, 2003; Weir et al. 2002), return on equity (Adjaoud, Zeghal & Andaleeb, 2007) and return on investment (Adjaoud et al. 2007).

For the purpose of the study, return on assets (ROA) is used as the accounting based measurement. ROA has been used in several studies on the firm financial performance (Bennedsen, Christian & Meisner, 2007; Erhardt, Werbel & Shrader, 2003; Haniffa & Hudaib, 2006; Kiel & Nicholson, 2003; Pudjiastuti, Mardiyah & Aida, 2007; Suaryana, 2005). ROA would be considered as an indicator of what has been accomplished by the management with the given assets. According to agency theory, managers are likely to squander and misappropriate the profits, leaving less return for owners (Haniffa & Hudaib, 2006). They further indicated that ROA is directly associated with the ability of management to use corporate assets efficiently, which essentially belong to owners. A lower ROA would refer to inefficiency. Further, Erhardt et al. (2003) found that ROA is significant in explaining the value of firm. Therefore, ROA is considered as a robust measurement of firm financial performance and is used in the current study.

3.6.2 Independent Variables

3.6.2.1 The Board Size

In terms of corporate governance viewpoint, each board should examine its size, with a view to determining the impact of the number upon its effectiveness. The board should include a balance of executive directors and non-executive directors (including independent non-executives) such that no individual or small group of individuals can dominate the board's decision making. Agency theory affirmed that the role of non-executive directors as monitors of management's performance and actions (Fama & Jensen, 1983) is independent and not intimidated by the CEO (Weisbach, 1988) and acts as a positive influence over directors' deliberations and decisions (Pearce & Zahra, 1992).

Due to the importance of ensuring board effectiveness, the board should not be too large or too small. Experts recommend that board size should have an average eight to nine directors on the board in order to ensure its effectiveness (Abdullah, 2001; Jensen, 1993; Yermack, 1996). Therefore, this study measures the board size by determining the total number of directors available on the board.

3.6.2.2 Board Independence

Based on the corporate governance code of UAE perspective, the board of directors must be balanced and at least one third of the board members should be independent, and a majority of members shall be non-executive members who shall have technical skills and experience for the good of the company. In regards to the issue, when selecting non-executive members of the company, it shall be taken into consideration that a member shall be able to pay adequate time and effort to his/her membership and that such membership is not in conflict with his/her other interests. Therefore, the board independent would be measured as the percentage of non-executive directors relative to the total directors in the board which were utilized by several researchers, such as(Hsu, 2007; Peng, Buck & Filatotchev, 2003).

3.6.2.3 CEO Duality (DUAL)

CEO duality means that the CEO is also the board chair. In order to test the relationship between CEO duality as independent variable and firm financial performance inductor ROA as a dependent variable, this study followed Mustafa (2006) and Peng, Zhang & Li (2007) and they measured it as dummy variable takes one if duality exits and zero otherwise.

3.6.3 Control Variables

3.6.3.1 Firm Size

Firm size has impact on the firm's financial performance. It is used widely as control variable in the empirical literature of corporate governance such as in (Ahmadu et al., 2005; Aljifri & Mustafa, 2007; De Andres et al., 2005; Ghosh & Sirmans, 2005; Mustafa, 2006). The use of firm size as a control variable in this study is motivated by the fact that it has been found to be associated with various firm characteristics. Lehn, Patro & Zhao (2003) argued that firm size and growth opportunities are important determinants of the size and structure of boards. They found that board size is directly related to firm size and inversely related to proxies for growth opportunities, whereas insider representation is inversely related to firm size and directly related to proxies for growth opportunities. Coles et al. (2001) argued that when the firm is growing, it may seek more board members to help oversee performance of managers or need new directors who have specialized board services to monitor the new growth.

Size of a company can be measured in a number of ways. For example, Haniffa & Huduib (2006) measured size based on natural logarithm of sales (LNSA) and Peng et al. (2007) measured size based on the natural logarithm of the book value of the total firm assets. In this study, total firm asset is used as a proxy of size and log firm asset is used as size variable in the multiple regression analyses. The total assets can be obtained through the non-current assets, property, plant and equipment, investment property, trade and other receivables, available for sale investments, investments in associates, goodwill, total non-current assets, current assets, land held for resale, trade and other receivables, bank balances and cash and, cash equivalents, inventories, total current assets, and total assets. In line with Ahmadu et al. (2005), De Andres et al. (2005), Ghosh and Sirmans (2005), Mustafa (2006), and Peng et al. (2007), this study measures firm size by using the natural logarithm of the book value of the total firm assets.

Table 3-1 Operationalisation of the Research Variables

Variables	**Acronym**	**Operationalisation**
Dependent variable: Return on assets (%)	ROA	Net profit divided by total assets.
Independent variables: Board size	BSIZE	Total number of directors on the board.
Board independence	RIND	The proportion of independent non-executive directors to total number of directors on the board.
CEO duality	DUAL	A dummy variable, taking a value of 1 for firms with CEO as Chair, and 0 otherwise.
Control variables: Firm Size	SZE	The natural log of total assets.

3.5 Method of Data Analysis

3.5.1 Descriptive Analysis

This descriptive study produced the mean, minimum, maximum and standard deviation for each variable for non-financial listed companies in ADX and DFM.

3.5.2 The Correlation of Variables

This study shows how one variable is related to another. The result of this analysis represents the nature, direction and significance of the correlation of the variables used in this study. The correlation between variables is analyzed by using Pearson's correlation.

3.5.3 Multiple Regressions

This study applies multiple regression analysis in order to test the hypotheses of the relationship between board characteristics and firm performance. The general structural equation used to explain the association is:

$ROA = \alpha0 + \beta1\ BSIZE + \beta2\ BIND + \beta3\ DUAL + \beta4\ SZE + \varepsilon$

Where:

ROA: Return on assets

α – Constant

BSIZE - Board size.

RIND - board independence

DUAL – duality role

SZE - firm size

ε - Error term

3.7 Chapter Summary

This chapter described the framework of the study which shows the chosen board's characteristics namely, board size, board independence and CEO duality that might influence financial performance (ROA) of non-financial companies listed on UAE Stock Exchange. It is hypothesized that these board characteristics influence the financial performance of UAE non-financial companies listed on UAE Stock Exchange.

CHAPTER FOUR

ANALYSIS AND FINDINGS

4.0 Introduction

This chapter highlights the results of the study based on the research objectives and the hypotheses. The results comprise descriptive statistics, correlations, and multiple regressions that are employed to determine the relations among the variables (independent and dependent). The data is based on annual reports and is analyzed using SPSS software version 18.

4.1 Descriptive Statistics

Descriptive analysis is conducted in order to provide clear information about the sample target which that can lead to easy and better interpretation of data (Genser, Cooper, Yazdanbakhsh & Barreto, 2007). In Table 4.1, the mean and stander deviation of the main variables of this study are illustrated below.

Table 4-1 Summary of Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
ROA	60	-23.2500-	26.9800	3.671815	7.7911929
Board Size	60	3	18	8.13	2.266
Board Independence	60	28.57	88.89	64.4725	14.72844
Duality	60	.00	1.00	.2500	.43667
Firm Size	60	6.50	12.30	9.2325	1.31287
Valid N (listwise)	60				

Based on descriptive analysis as summarized in Table 4.1, the mean value of ROA is 3.67 with companies that have maximum and minimum level of ROA 26.98 and -23.25 respectively. The standard deviation is 7.79. This shows that there is a wide variation in the return on assets (ROA) across the companies in the sample.

However, the mean value of board size for companies listed in UAE is 8 members with 18 as maximum and 3 minimum and the standard deviation is 2.26. On average, UAE listed companies chose their number of board members just close to optimal because Jensen (1993) and Lipton and Lorsch (1992) provide evidence that the average (or optimal) board size for U.S. firms is between 8 to 9 directors.

The mean of board independence is about 64.55% suggesting that boards of UAE firms contain a mixture of inside and outside directors. This is essentially good for the effectiveness of a board according to Fama and Jensen (1983) who argued that the effectiveness of a board depends on the optimal mixture of inside and outside directions.

Also, 75% of the firms studied adopt non-duality of board structure implying that about 25% of the firms have their CEOs and Board chairman positions combined in one personality. This suggests that the avenue for agency problems emanating from conflict of interest is minimized.

Firm size had a mean of 9.23 with minimum and maximum percent of 12.30 and 6.50 respectively, indicating that the bigger board size leads to better performance. According to Kyereboah-Coleman and Biekpe (2005) larger boards are better for corporate performance because they have more capabilities and expertise in assisting the management in decision makings and are harder for a powerful CEO to dominate. This results in improving governance, especially in enhancing company's management and financial performance.

4.2 Correlation Analysis

The second step in this section is an analysis of bivariate relationships between variables. Bivariate correlation analysis is an inter-dependence approach that aims to assess the magnitude of linear relationship between two continuous variables (Genser et al. 2007). This can be done using a correlation matrix.

Table 4-2 Correlation Matrix

		ROA	Board size	Independence	Duality	Firm size
ROA	Pearson Correlation	1	.510**	.134	-.306-*	.415**
	Sig. (2-tailed)		.000	.306	.017	.001
	N	60	60	60	60	60
Board size	Pearson Correlation		1	.269*	-.154-	.364**
	Sig. (2-tailed)			.037	.240	.004
	N		60	60	60	60
Independence	Pearson Correlation			1	-.293-*	-.067-
	Sig. (2-tailed)				.023	.613
	N			60	60	60
Duality	Pearson Correlation				1	-.070-
	Sig. (2-tailed)					.598
	N				60	60
Firm size	Pearson Correlation					1
	Sig. (2-tailed)					
	N					60

**. Correlation is significant at the 0.01 level (2-tailed).
*. Correlation is significant at the 0.05 level (2-tailed).

Based on table 4.2, the result of the analysis obtained shows that a significant positive relationship between firm size and firm financial performance existed. The correlation value of these variables is r= 0. 510** at sig= .000 and is a positively significant correlation. It indicated that the relationship between the two variables is a good one.

The correlation value between board independence and firm financial performance is r=0.134 at sig=.306. That shows the relation between them is not significant. Whereas, the relationship between CEO duality and firm financial performance r = -.306 at sig=.017 is negatively significant. Furthermore, the control variable firm size is found to be highly correlated with firm financial performance, r =.415 at sig=.001.

4.3 Assumption of Multiple Regressions

Before running the multiple regression analysis, it should be noted that there are some basic assumptions in undertaking any multiple regression analysis. To test the data normality and linearity assumptions of the regression models in this study, histogram charts of the distribution of the residuals are plotted.

The existence of multicollinearity which is high correlation between the independent variables is also a serious problem in multiple regressions because the effect of each independent variable on the dependent variable becomes difficult to identify. According to Hair, Anderson, Tatham and Black (1995) one of the ways that is used to check whether there is any relation among independent variables is multicollinearity which describes the degree to which any variable's effect can be predicted by the other variable. A widely used method to detect for and measure multicollinearity is the Variance Inflation Factor (VIF) for each independent variable (Naser, Al-Khatib & Karbhari, 2002). Accordingly, the correlation analysis showed that there is no multicollineraity, but for further confirmation VIF has been conducted which are shown in Table 4.3. In a situation where the VIF is above 10, the independent variables are considered highly correlated, causing a multicollinearity problem (Silver, 1997). Thus, the multicollinearity diagnostics command to include the VIF is selected when running the multiple regression models. The results in Table 4.3 revealed that there is no multicollinearity problem because VIF for each independent variable is less than 10.

Table 4-3 Variance Inflation Factor

Variable	Collinearity Statistics	
	Tolerance	VIF
Board Size	.779	1.284
Board Independence	.830	1.205
Duality	.904	1.106
Firm Size	.835	1.198

4 .4 Hypotheses Testing

This section presents an analysis and discussion of the relationship between firm's financial performance which measured by ROA as dependent variable and board size, board independence and CEO duality as independent variables, and firm size as control variables, using a multiple regression technique. The outputs of multiple regressions shown in Tables 4.4, 4.5 and 4.6 are related with ROA, as dependent variable.

Table 4-4 Summary of the Regressions Model (ROA)

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.611[a]	.373	.327	6.3904814

a. Predictors: (Constant), Board Size, Board Independence, Duality, Firm Size
b. Dependent Variable: ROA

The results as measured by R^2 indicates the impact of the independent variables on the dependent variable, by which, the independent variables explain 37.3% of the variance in the ROA as shown in the Table 4.4 above. Based on the adjusted R^2 of 32.7%, it can be confirmed that more than half of relationship with ROA can be explained by the four independent variables used in this research. The remaining 67.3% of the impact to ROA is explained by other factors.

Table 4-5 Result of Multiple Regression Analysis

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1335.355	4	333.839	8.175	.000[a]
	Residual	2246.104	55	40.838		
	Total	3581.459	59			

a. Predictors: (Constant),Board Size, Board Independence, Duality, Firm Size
b. Dependent Variable: ROA

Table 4.5 shows the model F-value= 8.175 at significant level .000, indicating the model is fit and the independent variable namely BSIZE, BODIND, DUAL, SIZE are significantly related with dependent variable firm financial performance.

Table 4-6 the Coefficients of Multiple Regression Analysis

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	-19.417-	7.492		-2.592-	.012		
	Board Size	1.329	.416	.387	3.196	.002	.779	1.284
	Board Independence	-.011-	.062	-.022-	-.184-	.855	.830	1.205
	Duality	-4.191-	2.004	-.235-	-2.091-	.041	.904	1.106
	Firm Size	1.523	.694	.257	2.195	.032	.835	1.198

a. Dependent Variable: ROA

Based on the regression analysis, the equation of ROA as the dependent variable can be derived as below:

ROA = BOARD SIZE+ CEO DUALITY+FIRM SIZE

From the equation of ROA found in Table 4.6, it is noted that if the board size increases by one, then performance ROA will increase by about 1.329. Firms that have separation between the positions of board chairman and CEO achieve ROA that increase about 4.191 when compared to the firms that have CEO duality. If size increases by one unit then the ROA will increase by about 1.523.

Table 4.6 presents the regression results of relationship between return on assets (ROA) and the governance variables and the control variable. The output indicates mixed results between the governance variables and the performance variable where the board size on this occasion has positive impact on ROA. This result is similar to what has been found in other studies such as

(Dalton & Dalton, 2005; Kyereboah-Coleman & Biekpe , 2005).

Regarding the board independence, the result shows that it is found not to be significantly related to firm financial performance of ROA. This result is consistent with prior studies such as (Bhagat & Black, 2001; De Andres et al. 2005; Haniffa & Hudaib, 2006) who argued that some directors in developing countries may not be able to contribute to reducing the agency conflicts related with the potential misallocation of excess resources, because they are not elected due to their skills and experience but more often for political reasons, to legitimise business activities and for contacts and contracts. Also, few researches (Chin et al. 2004; Fosberg, 1989; Klein, Shapiro & Young, 2005) do not show any relationship between the presence of non-executive directors on the board and firm financial performance.

In terms of CEO duality, the result shows that there is a negative association between the CEO duality and firm financial performance. This finding is in line with Schmid & Zimmermann (2007) and Wan & Ong (2005).The firm size has a positive impact on ROA, and that is consistent with Klapper & Love (2004) and Aljifri & Mustafa (2007). In conclusion, this finding may reflect an independent source of value creation, possibly due to market influence and economies of scale and scope (Bohren & Odegaard, 2005).

4.5 Summary

This chapter elaborates the results of the analysis that is conducted by using several tools. The normality and linearity tests show that the data meets the assumptions of multiple regressions and there is no multicollinearity problem. The analyses provided evidence that board size and firm size are positively and significantly related to firm financial performance. However, this study failed to find any significant relationship between board independence and firm financial performance and the study found that the relationship between CEO duality and financial performance variable is significantly negative. The following chapter contains the discussion, conclusion, and recommendation.

CHAPTER FIVE

DISCUSSION, CONCLUSION AND RECOMMENDATION

5.0 Introduction

This study examines the relationship between certain board of directors' characteristics namely; board size, board independence and CEO duality with firm financial performance of UAE's non-financial companies that are listed on Emirates securities market. Using a sample of 60 listed companies in 2010, this study examines three hypotheses and one control variable in the regression framework. This chapter is divided into three sections. First is the introduction of the chapter. The second section is the discussion and summary of research and the final section discusses the limitations and suggestions of future research.

5.1 Discussion and Summary of Research

The main purpose of this study was to examine the impact of corporate governance mechanisms (board characteristics) namely; board size, board independence and CEO duality in the context of the firm financial performance (ROA), and considered the firm size as a control variable. A general finding of this study was consistent with previous studies and the present section elaborates each objective separately.

The first objective was to investigate the influence of size board of director on firm financial performance. The achievement of this objective was based on the hypotheses that, "there is significant relationship between the board size and firm financial performance". Thus, this study found a positive significant relationship between the board size and firm financial performance (ROA). Consequently, this finding supported the hypothesis and fully achieved the objective and clearly answered the related research question. Furthermore, based on the finding, board size has an important role in enhancing the firm financial performance especially in UAE listed company context. Moreover, this is consistent with the previous studies such as Dalton and Dalton (2005) and Kyereboah-Coleman and Biekpe (2005) which found a positive significant relationship between the board size and firm financial performance. In line with that, the larger board size, the better performance can be achieved, and would provide extra board monitoring and subsequently corporate players could perform their duties effectively and efficiently in enhancing shareholders value. Therefore, higher number of directors may increase the number of potential solution strategies, increase the range of perspectives, provide an increased pool of expertise, provide better networking, and be more capable of monitoring the actions of top management.

The second objective was to determine the influence of board of director's independence on firm financial performance. In order to accomplish this objective, hypothesis was affirmed as," there is a significant relationship between proportion of independent directors in the board and firm financial performance. Accordingly, the regression analysis result showed that board independence had no significant relationship with firm financial performance (ROA). As a result, this finding does not support the hypotheses. Unsurprisingly, this result is consistent with the previous studies such as Chin et al. (2004); Fosberg (1989); Klein, Shapiro & Young, (2005). It can be realized that a high level of board independence does not automatically lead to better performance. For further confirmation, Bhagat & Black (2001), De Andres et al. (2005) and Haniffa & Hudaib (2006) indicated that such directors may not be able to contribute to reducing the agency conflicts related with the potential misallocation of excess resources, because they are not elected due to their skill and experience but more often for political reasons, to legitimise business activities and for contacts and contracts. They further affirmed that this occurs especially in developing countries, and the present study is conducted involving UAE which is considered as a developing country.

This finding can be justified based on many reasons such as differences in corporate law, capital markets, internal capital structure of the firm, and structure of company ownership. These factors are more concentrated in UAE market compared to developed countries, which may have had a hand in influencing the relationship. Moreover, UAE introduced corporate governance code in 2007 which was made compulsory by April 2010. The present study has been conducted in 2011 relying on 2010 data for UAE listed companies. Owing to early stage of implementation of corporate governance in UAE, the rules for governance and control mechanisms have still not been effectively enforced, which that may affect the relationship between the board independence and firm financial performance.

Based on the aforementioned fact, the independent directors in UAE are still not really performing well and their functions are characterized as weak governance functions, because they have lack of knowledge about the firm, lack of authority, definable shareholder interest and some directors have a personal relationship with the CEO, which may compromise their independence.

In addition, the composition of non-executive directors and the proportion of family member representation might also influence the firm financial performance. In UAE where families have substantial equity holdings, there is generally little physical separation between those who own and those who manage the capital. As an example in Malaysia, Meng (2009) indicated that there are a number of listed companies with substantial family shareholdings and that elect family members to sit on the boards. The boards of family-controlled companies are dominated by family members or their close friends, and there are few truly independent directors. It can be concluded that the calls for independent boards still exist up to this day.

The third objective was to examine the influence of CEO duality on firm financial performance. In order to carry out this objective, hypothesis was stated as, "there is a significant relationship between proportion of CEO duality and firm financial performance". The result shows that there is a negative significant relationship between the performance of firms in terms of ROA and CEO duality. Thus, this finding supported the hypotheses, and is also in line with previous studies such as (Schmid & Zimmermann, 2007; Wan and Ong, 2005) that found that CEO duality is negatively associated with firm performance. In regards to that, when one personality is holding two important positions; he/she are likely to pursue strategies which advance his/her own personal interests over those of the company. This is confirmed by the agency theory which believes that the separation of the two roles is crucial for the monitoring of the effectiveness of the board over management, by providing cross checking evidence against the possibility of over-ambitious plans by the CEO. In concludes that, the separation of power, with two separate individuals holding the position of chairman and CEO is a crucial factor of enhancing the firm financial performance.

In the end, the firm size is considered as a control variable, and showed significant positive association with firm financial performance. This result is consistent with prior studies. For instance, Hossain, Prevost & Roa (2001), Hsu (2007) and Pudjiastuti et al. (2007) found a significant positive relationship between firm size and firm financial performance. Therefore, the result suggests that larger companies tend to have higher performance.

5.2 Limitation and Future Research

5.2.1 Limitations of the Study

Even though the result of this study may provide several insights that could be of interest to scholars, shareholders, government, policy-markets, institutions investigations and other relevant stakeholders, it still has limitations like other studies.

Firstly, this study has concentrated only on UAE listed non-financial companies with an oversight of other financial companies. So, the validation of the conclusion might not hold for financial companies and other companies outside those lists.

Secondly, this study used only accounting measure (ROA) for measuring firm's financial performance, while other measurements are ignored. The study ignored other methods of performance measurement reflecting market phenomenon such as return on equity (ROE), Tobin's Q and return on investment (ROl).

Thirdly, the study only examined certain variables to determine the board effectiveness such as board size, independence, and CEO duality and its relationship to firm financial performance, even though there are some other important factors such as board process, and variability. Moreover, theses limitation exists due to the nature of the data collected that relied on the annual reports' disclosures form UAE listed companies.

5.2.2 Suggestions for Future Researches

The results of this study can be a starting point for future researches in order to empirically explore the importance of corporate governance structures in UAE. As long as the implementation of the code of corporate governance is at its early stage in UAE, the gap leads to vague explanations and requires further studies. In this regard, this study can encourage and highlight some recommendations for future studies to be conducted in the area of interest, and to overcome the limitation of this study. It can be highlighted as follows:

1. Include other unlisted companies and financial companies by making use of a different method.
2. Consider other performance measures such as return on equity (ROE), Tobin's Q and return on investment (ROl).
3. Extend the period of using data for more than one year.
4. Consider other aspects of corporate governance variables that are not included in this study and examine board process such as remuneration and nominating committees, board of director's frequency meeting and experience of board of directors.

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