



Board Composition and Firm Performance: Evidence from Bangladesh

Afzalur Rashid^a

Anura De Zoysa^b

Sudhir Lodh^{**b}

and

Kathy Rudkin^b

Abstract

This study examines the influence of corporate board composition in the form of representation of outside independent directors on firm economic performance in Bangladesh. Two hypotheses are developed to examine the relationship among composition of board memberships including independent directors and firm performance. An observation of 274 Bangladeshi firm-years is used in the study. A linear regression analysis is used to test the hypotheses. Results reveal that the outside (independent) directors cannot add potential value to the firm's economic performance in Bangladesh. The idea of the introduction of independent directors may have benefits for greater transparency, but the non-consideration of the underlying institutional and cultural differences in an emerging economy such as Bangladesh may not result in economic value addition to the firm. The findings provide an insight to the regulators in their quest for harmonization of international corporate governance practices.

JEL Classification: G34, G39

Keywords: Board Composition, Independent directors, Firm Performance, Bangladesh.

** Corresponding author: siodh@uow.edu.au.

a University of Southern Queensland, Australia

b University of Wollongong, Australia

1 Introduction

Bangladesh actively pursues a regulatory environment that aligns its corporations with international accepted corporate governance best practice. This study challenges the taken-for-granted assumption in this strategy that corporate governance principles derived in advanced economies can be assumed to transfer unproblematically to emerging economies. Rather it is argued when examining corporations in the Bangladeshi context, where the legal form of the corporation is comparable with that of advanced economies, contextual features undermine such considerations.

A sample of 274 Bangladeshi firms is observed to determine the relationship among board composition, independent directors and firm performance. We argue that with respect to corporate board composition, the representation of outside independent directors on boards in Bangladesh cannot add economic value to Bangladeshi firms.

The concept of public limited companies is universal. Public limited companies emerged in the mid-nineteenth century as a form of business ownership that enabled a greater potential to raise capital and to limit investors' risk to their respective equity investments. Historically public limited companies were controlled by their owners, either through direct management or through direct control of management by owners (Mintzberg, 1984). However, as the size of limited companies grew, direct owner involvement was no longer practical. With the increase and dispersion of ownership and the cessation of direct involvement in corporations' management, a profession of management emerged (Berle and Means 1932). Consequently, the ownership control of the modern corporation is vested in the hands of management leading to a so-called managerial hegemony (Mintzberg, 1984). This creates an agency problem of aligning the interests of shareholders with that of management.

To mitigate the agency problem, Rose (2005) argues that the corporate board plays a key role in supervising management and aligning their interests with the interests of shareholders. The board is considered to be a primary internal corporate governance mechanism (Brennan, 2006), as the board monitors and supervises management, and gives management strategic guidelines. It may act to review and ratify management's proposals (Jonsson, 2005). A board works to enhance the firm performance and enact legally vested responsibilities and fiduciary duties (Zahra and Pearce II, 1989). The board's expertise can also spot problems early and may "blow the whistle" (Salmon, 1993). There is a lacuna of studies as to whether the composition of boards of directors can meet these stated responsibilities in the same ways in differing market contexts and jurisdictions in which they operate.

Corporate governance convention adopted from advance markets' codes and principles in fulfilling the role of a board require executive and non-executive directors to work together. It is assumed that boards without

non-executive directors act as a rubber stamp, and are dominated by the Chief Executive Officer (CEO), and are plagued with conflicts of interests (Weidenbaum, 1986). Jensen (1993, p 421) argues that the “board culture is an important component of board failure”.

The wave of corporate scandals, for example, Enron, WorldCom and HIH lead to the question as to what composition of board is best able to monitor management (Mizruchi, 2004, p 614; Brick *et al.*, 2006, p 421). Enron, WorldCom and HIH management were all involved in questionable accounting practices which were undetected by their respective boards (Main, 2002; Lawrence, 2004; Kaplan and Kiron, 2004; Solomon, 2007). Regulatory corporate governance reports and codes; for example, Sarbanes-Oxley Act 2002 in United States; Cadbury Report 1992, Higgs Report 2003 and Smith Report 2003 in the United Kingdom and CLERP 9 and the Ramsay Report 2001 in Australia advocate many boardroom reforms. The Higgs Committee recommended the independence of outside directors be tested. There is a widespread response to the Higgs Committee Recommendations (Kirkbride and Letza, 2005). Consequently, many countries around the world undertook corporate governance reforms.

As part of reform movements, in 2006 Bangladesh introduced a hybrid regulation which is nomenclature as the Corporate Governance Notification (CGN). This CGN follows a western model requiring appointments on a corporate board of at least one-tenth of the total directors subject to a minimum of one as an independent director (Rashid and Lodh 2008). Non-compliance requires an explanation. This regulation in Bangladesh is of interest because over the past decades an overwhelming proportion of corporate governance literature has concentrated on advanced economies with developed financial and legal systems (Ararat and Yurtoglu, 2006). Although there exist several studies on corporate governance in less developed and emerging economies (Shleifer and Vishny, 1997; Sarkar *et al.* 1998; Asian Development Bank 2000; Rwegasira 2000; Gibson, 2003; Denis and McConnell, 2003; Machold and Vasudevan, 2004; Yammeeri *et al.* 2006), in the context of Bangladesh there are very few studies on corporate board practices and governance. This study extends the literature on corporate board practices and firm performance by providing evidence from this emerging economy. In particular, this study attempts to investigate whether board composition in the form of outside independent directors as considered in advanced systems, can influence firm economic performance in Bangladesh.

The remainder of the paper is organized as follows. Section 2 presents the background literature of this study. Section 3 elaborates on the institutional background of corporate board practices in Bangladesh. Section 4 discusses the methodology and definitions of variables for the analysis. Section 5 presents empirical results. Section 6 discusses the limitations of this study and the conclusions drawn.

Background Literature

The United Kingdom Cadbury Report (Cadbury, 1992, p. 15) defined corporate governance as “the system by which companies are directed and controlled”, including board practices and composition and their relationship to firm performance. Agency literature views management as opportunistic (Jensen and Meckling, 1976) arguing that an individual is self-interested and self-opportunistic, rather than altruistic. It assumes that due to the separation of ownership and control, managers (agents) will not align their interests in the firm with that of the owners, being driven by self-interest. Unless restricted from doing otherwise, management will undertake self-serving activities that could be detrimental to the economic welfare of the principals (Deegan, 2006, p 225). It is argued that boards comprising outside independent directors will counter the agency problem by being able to monitor any self interested actions by managers (Zahra and Pearce II, 1989; Bathala and Rao, 1995; Nicholson and Kiel, 2007; Kaymak and Bektas, 2008). This may in turn enhance firm performance (Luan and Tang, 2007). The agents will be motivated, however, to work in the interests of owners only if there is an oversight incentive to do so in the form of independent directors who set the tone for less opportunistic behaviour by managers. It is argued that in so doing, outside independent directors may provide more skills and knowledge for the benefit of the corporation.

Earlier Studies on Board Composition

It is widely debated in the corporate governance literature as to whether board composition in the form of representation of outside independent directors may add any economic value to the firm (Kesner *et al.*, 1986; Hermalin and Weisbach, 2003; Petra, 2005). Prior research on board composition mainly focused on firms in advanced economies (Guest, 2008). Studies for example by Kaplan and Reishus (1990), Byrd and Hickman (1992), Brickley *et al.* (1994), and Beasley (1996) found a positive impact from appointing outside independent directors onto the board. Kesner *et al.* (1986) found that, although independent directors are not involved in illegal acts, adding outside independent directors cannot lessen a firm’s illegal acts. Fernandes (2005) documented that the firms with non-executive directors have less agency problems and have a better alignment of shareholders and managers’ interests. Rosenstein and Wyatt (1990) show that the firm share price goes up when an additional outside director is appointed. Denis and Sarin (1999), in a study using a time-series analysis over a 10-year period, found that the changes in ownership and board structure are correlated with one another. Changes in ownership and board structure are strongly related to top executive turnover, prior share price performance, and corporate control threats. Cotter *et al.* (1997) studied the role of independent

outside directors during takeover attempts by tender offer. They found that independent outside directors enhance target shareholder's gains from tender offers and a majority of independent directors are more likely to use resistance strategies to enhance shareholders' wealth.

The empirical evidence of outside independent directors and firm performance is mixed. Some studies, such as Schellenger *et al.* (1989), Daily and Dalton (1992), Tian and Lau (2001) and Luan and Tang (2007) found that having more outside independent directors on the board improves firm economic performance. Other studies including Baysinger and Butler (1985), Chaganti *et al.* (1985), Rechner and Dalton (1986), Zahra and Stanton (1988), Fosberg (1989), Hermalin and Weisbach (1991), Barnhart *et al.* (1994), Grace *et al.* (1995), Barnhart and Rosenstein (1998), Dalton *et al.* (1998), Dalton and Daily (1999), Davidson III and Rowe (2004), Fernandes (2005), and Cho and Kim (2007) could not find any relationship between board composition in the form of representation of outside independent directors and firm performance.

Baysinger and Butler (1985) argued that these differences in findings may occur due to various factors such as corporate law, managerial talent, capital markets and the internal capital structure of the firm. In addition, Zahra and Pearce II (1989) pointed to several reasons for such inconsistencies, as summarized by Finkelstein and Hambrick (1996, p 239). These include the consideration of several contextual factors; life cycle, corporate strategy and effective interaction among board members in decision making. Finkelstein and Hambrick (1996) also argue that despite such variances, a board may indirectly influence the firm's performance by quality of monitoring. Due to the high degree of diversity of the results of earlier studies on board composition and firm performance, Dalton and Daily (1999) viewed these results as 'vexing', 'contradictory', 'mixed' and 'inconsistent'.

As has been stated earlier, the CGN (2006) requires the appointment of at least one tenth of the total directors, subject to a minimum of one independent director. Given this requirement, there will be an imbalance of power between inside and outside directors, dependent upon the board size. A smaller board is manageable and plays a controlling function, whereas a larger board is non-manageable and may have greater agency problems and may not be able to act effectively leaving management relatively free of being controlled (Chaganti *et al.*, 1985; Jensen, 1993; Hermalin and Weisbach, 2003). Del Guercio *et al.* (2003) reveal that smaller boards with a higher proportion of independent directors are more effective.

Why Outside Independent Directors?

Independent non-executive directors are appointed from outside and they should not have any material interest in the firm. Dalton and Daily (1999) and Fields and Keys (2003) argue that independent directors are appointed based

on their unique qualifications, expertise and experience. The view is that they may effectively influence the board's decisions and ultimately add value to the firm. It is argued independent directors provide a unique monitoring function (Jensen and Meckling, 1976; Fama, 1980; Bathala and Rao, 1995; Beasley, 1996). Farrar (2005) suggests independent directors play a useful role in strategic planning and risk management. It is also recognized that independent directors share the responsibility to monitor a firm's financial performance. In so doing, they have authority to question problems of information asymmetry (Ozawa, 2006, p 104), and have the power to make recommendations on executive compensation and dismissal of the CEO following poor performance (Kesner *et al.*, 1986; Finkelstein and Hambrick, 1996, p 225; Hermalin and Weisbach, 2003).

The practicality of appointing independent directors is challenging. There is no consensus of a common definition of independent director as yet (Brennan and McDermott, 2004, p 326). They are neither employees of the company, nor have they any business relationship with the firm (Hulbert, 2003). If the appointment of independent directors is to achieve these intended functions, the appointment of such directors must be transparent and at arms' length. However, such appointments can be controversial if there are questions as to the independence of appointments. It is possible that independent directors are known to the CEO or other inside directors prior to their appointments. The new outside board members who are proposed by inside board members may have personal relationships with them (Finkelstein and Hambrick, 1996, p 225).

Arguments have been presented challenging the limitations of outside independent directors. Nicholson and Kiel (2007, p 588) argue that "inside directors live in the company they govern, they better understand the business than outside directors and so can make better decisions". Their argument is one of information asymmetry between inside directors and outside independent directors. They argue that a lack of day to day inside knowledge may reduce the control role of the independent directors in the firm, and that the independent directors may fail to perform because of appropriate support by the inside directors (Cho and Kim, 2007). Brennan (2006) also questions the value of outside independent directors, as they may not be competent to perform their assigned tasks in that they are part-timers and do not have inside information of the firm.

The problem of finding truly outside independent directors has been noted. Flanagan (1982) argues that 80 percent of the outside directors' candidature in the United States is known by either the CEO or by other board members prior to their appointment. Patton and Baker (1987) and Jensen (1993) argue that outside directors are the creatures of CEOs and are more likely to be aligned with top management rather than that of the interests of shareholders, as top management have great influence over who sits on the board. However,

Brickley *et al.* (1994) argue that due to reputational concerns and fear of lawsuits, outside directors may be motivated to represent shareholders, but that the ability to issue commands and instructions by these directors is limited (McNulty and Pettigrew, 1996). Dayton (1984) argues that outside independent directors only monitor in the case of crisis. Outside independent directors may serve on too many boards (Core *et al.*, 1999).

Institutional Background of Corporate Board Practices in Bangladesh

While corporate governance reforms in Bangladesh are consistent with global reforms concerning outside independent directors (cf., CGN 2006), the Bangladeshi institutional environment lags behind. Typically owners often have significant stakes of shares and dominate the board of directors. This form of governance is known as the ownership control approach and is in contrast to corporate governance practices that make use of outside independent directors. Highly concentrated ownership and consequential board influence can have dominating features where there exists a lack of takeover regulations, an inefficient market, and transaction costs associated with takeover processes. Corporate governance in Bangladesh is not without such characteristics. In Bangladesh, an absence of a liquid capital market and other dominant control mechanisms including compensation in the form of share options, are also major features.

In general corporate boards in Bangladesh are one-tiered or management without the use of any supervisory board. Both executive and non-executive directors perform duties together in one organisational layer. This is not commonly seen in advanced systems of corporate governance. An indication of CEO duality in corporate board supervision is an example of such a one-tiered structure. Similarly there exists CEO duality in some listed companies in Bangladesh.

Methodology and Definition of Variables

Methodology

The Securities and Exchange Commission Bangladesh (SECB) announced a corporate governance notification (CGN 2006). One of the requirements of that notification is to appoint outside independent directors onto boards, otherwise an explanation is needed for any non-compliance. Many firms subsequently complied with this guideline. Based on the availability of company annual reports, this study considers 90 non-financial firms listed on the Dhaka Stock Exchange (DSE) during the period 2005 to 2009. This represents 38.3% of the total DSE listed companies as at 31 December 2009. It comprises 61.6% of total non-financial companies; representing 55% (approximately) of the market

capitalization of total non-financial listed firms. A total of 274 observations are made for this study, as shown in Table 1. The sample consists of a variety of industries as shown in Table 2.

The audited financial reports from companies are the basis for obtaining accounting information including total assets, total liabilities and equities, net sales, net incomes, and operating incomes. The data for board composition and board size are obtained from directors' reports. Market values of the closing share prices are also collected from the DSE web site and from the Monthly Review of the DSE.

Table 1:
Sample Description

Year	Number of firms in the sample	Observed firm years
2005	90	10
2006	90	90
2007	90	90
2008	90	78
2009	90	6
Total observations (Firm years)		274

Table 2:
Industry classification of the sample

Industry	Number of firms in the sample	Observed firm years
Cement	3	9
Ceramic	1	3
Engineering	13	43
Food and Allied	17	48
Fuel and Power	2	5
Jute	2	6
Paper and Printing	3	9
Pharmaceuticals and Chemicals	16	49
Service and Real Estate	2	5
Tannery	4	15
Textile	23	69
Miscellaneous	4	13
Total	90	274

Based on the background literature, two hypotheses are stated as follows:

H₁: There is a significant positive relationship between the board composition and firm performance.

H₂: There is a significant negative relationship between the board size and firm performance.

Variable Definitions

Dependent Variable: Firm Performance

Dependent variables in this study are the firms' performances under different performance measures such as Return on Assets (ROA) and Tobin's Q (a market based performance measure). Consistent with Yammeesri and Lodh (2004), Yammeesri *et al.* (2006) and Rashid and Lodh (2008), ROA is calculated as 'Earnings Before Interest and Taxes' (EBIT) scaled by the book value of total assets. Tobin's Q is the ratio of the market value of the firm to the replacement cost of their assets.

Independent Variable: Board Composition

Board composition in this study refers to the percentage of membership held by the outside independent directors, which has been considered in prior studies (Rechner and Dalton, 1986; Zahra and Stanton, 1988). This satisfies the definition of an independent director as provided in the CGN 2006 issued by SECB. Independent variable BDCOM is used to denote the board composition.

Control Variables

The considered control variables are as follows; ownership structure, board size, CEO-duality, firm debt, firm size, firm age and firm growth. The shares of public limited companies in Bangladesh are not widely held. Apart from a few controlling ownerships by foreign investors and government and financial institutions, the public limited companies in Bangladesh are in general mainly controlled by family members who are founding sponsors and/or directors, leading to a high degree of ownership control. The company board is generally formed from the representation of these shareholdings. In our view, family directors or sponsors are highly influential in appointing any new director in Bangladesh. Therefore, ownership structure in Bangladesh has a significant impact on the board's role of monitoring management, which in turn can influence firms' performance. A control variable director shareholdings ownership (DIROWN) is considered for the percentage of shares owned by the directors or sponsors.

A control variable board size (LOGBDSIZE) is considered to be the natural logarithms of total board members. Whether a CEO would have a great influence on board structure and its capacity to monitor management depends on the distribution of power between the chairperson of the board and the CEO (Finkelstein and Hambrick, 1996). A control variable CEO-duality

(CEOD) is considered as a binary, which is equal to be one (1) if the CEO and chairperson positions are held by the same individual, otherwise zero (0).

Firm debt may act as a disciplinary device to agency problems which ultimately can have influence on a firm's performance (Jensen and Meckling, 1976). Consistent with McConnell and Servaes (1990), Agrawal and Knoeber (1996), Short and Keasey (1999) and Xu and Wang (1999), a control variable debt (DEBT) is also considered to identify the impact on firms' performance. It is measured as the ratio of Total Debts to Total Assets.

The firm size is an important variable because large firms can be influenced by having more capacity to generate internal funds (Short and Keasey, 1999), having a greater variety of capabilities (Majumdar and Chhibber, 1999), and having problems of coordination which may negatively influence performance (Williamson, 1967). The natural logarithm of Total Sales is considered as the firm size (LOGSIZE).

Firm performance can also be influenced by the age of the firms. Older firms are likely to achieve greater efficiency by reducing costs than younger firms (Ang *et al.*, 2000). The variable of age (LOGAGE) is defined here as the natural logarithm of years the firm is on the DSE.

Regression Model Specification

In order to examine the relationship between board composition and firm performance, the following model is developed:

$$= \alpha + \beta_1 BDCOMP_{it} + \beta_2 DIROWN_{it} + \beta_3 LOGBDSIZE_{it} + \beta_4 CEOD_{it} + \beta_5 DEBT_{it} + \beta_6 LOGSIZE_{it} + \beta_7 LOGAGE_{it} + \epsilon_{it}$$

Where,

- Y_{it} is alternatively ROA_{it} and Tobin's Q_{it} for *i*th firm at time *t*,
- $BDCOMP_{it}$ is the board composition,
- $DIROWN_{it}$ is the percentage of shares owned by directors for *i*th firm at time *t*,
- $LOGBDSIZE_{it}$ is the board size for *i*th firm at time *t*,
- $CEOD_{it}$ is the CEO duality for *i*th firm at time *t*,
- $DEBT_{it}$ is the debt ratio for *i*th firm at time *t*,
- $LOGSIZE_{it}$ is the firm size for *i*th firm at time *t*,
- $LOGAGE_{it}$ is the firm age for *i*th firm at time *t*,
- α is the intercept, β_i is the regression coefficient of *i*th variable and ϵ_{it} is the composite error terms, and
- The subscript *i* represents the different firms and *t* represents the different years.

Empirical Result

Descriptive Statistics

The descriptive statistics of all variables used in the model are shown in Table 3.

As per Table 3, average firm performance is 5.7% ranging from negative 149.4% to 28.7% under the ROA performance measure, and 129% ranging from 33.5% to 622.6% under Tobin's Q performance measure. The average board composition is found to be 10.9% ranging from 0% to 33.33%. The average directors' shareholding is found to be 42.3%, ranging from 0% to 96%. The average board size is 7 directors, ranging from a minimum of 3 directors to a maximum of 12 directors. On an average it shows that there is 41.7% incidence of CEO duality in the observed sample. The average Total Debt to Total Assets (DEBT) is 77.4% ranging from 7.3% to 561.9%. The average firm size is 5.459 implying an average firms' sales of Taka 234.86 million. The average firm age is 18 years ranging from 8 years to 32 years.

The results of the analysis carried out to examine the correlation between the explanatory variables and are presented in the correlation matrix in Table 4, which demonstrates that none of the explanatory variables is correlated with another explanatory variable in the model. This is further confirmed by the scores of variance inflation factor (VIF) which quantifies the severity of multicollinearity in a regression analysis. A VIF value of ten is considered as a cut off value for multicollinearity (Gujarati, 2003).

Table 3:
Descriptive Statistics of the Sample

Variables	N	Mean	Minimum	Maximum	Std. Deviation	Skewness	Kurtosis
ROA	274	0.057	-1.494	0.287	0.132	-6.278	69.833
Tobin's Q	274	1.290	0.335	6.226	0.769	2.566	9.873
BDCOMP	274	0.109	0.000	0.333	0.082	-0.077	-0.751
DIROWN	274	0.423	0.000	0.960	0.190	0.069	0.423
LOGBDSIZE	274	1.857	1.099	2.485	0.304	-0.269	-0.102
CEOD	267	0.416	0.000	1.000	0.494	0.344	-1.896
DEBT	274	0.774	0.073	5.619	0.629	4.061	22.483
LOGSIZE	274	5.459	-4.200	10.724	2.398	-0.937	1.132
LOGAGE	274	2.858	2.079	3.466	0.312	-0.082	-0.836

Table 4:
Correlation matrix of the explanatory variables

	BDCOMP	DIROWN	LOGBDSIZE	CEOD	DEBT	LOGSIZE	LOGAGE	VIF
BDCOMP	1							1.266
DIROWN	-.060	1						1.027
LOGBDSIZE	.340**	-.028	1					1.220
CEOD	-.211**	.136*	-.111	1				1.100
DEBT	-.123*	-.030	-.033	.006	1			1.082
LOGSIZE	.293**	-.051	.258**	-.084	-.321**	1		1.207
LOGAGE	.237**	.002	.248**	-.219**	.082	.086	1	1.143

* At 5% level of significance and ** at 1% level of significance respectively.

The model is regressed using linear regression analysis by the SPSS (The Statistical Package for Social Science). The regression results are presented in Table 5. Results indicate that there is no significant relationship between board composition and firm performances in either measure. This implies that the outside independent directors cannot influence firms' economic performance. The results also confirm that board size has a significant negative explanatory power in influencing firms' performance under the ROA measure, but it shows a positive explanatory power in influencing firm performance under Tobin's Q measure. This is indicative of information asymmetries between inside and outside directors. The results further indicate that rather, CEO-duality, Firm Debt and Firm Size all having significant explanatory power in determining firm's performance under the market based performance measure. The results also show that the firm size has a significant positive explanatory power in determining firm's performance in the ROA measure.

The relationship between outside directors and firms' performance is not clear explicitly in case of developed economies (Judge *et al.*, 2003). This study also supports this argument, finding that outside independent directors are good monitors but cannot add economic value to firms in Bangladesh. It should however be mentioned that the data were mainly collected from the companies' annual reports which may have explanatory power for additional causes on true companies' performance. Also, the data were collected from entities ignoring the underlying differences of their operations, as any two organisations are not the same. The extreme value of some observed variables such as EBIT and accumulated income of some firms may have further impacts on the results. The sample size could have influences on the results as firms were required to comply with the CGN (2006) notification.

Table 5:
Board composition and firm performance
under different performance measures

This table presents the summary results of the board composition and firm performance under different performance measures. Column (a) and (b) represent the coefficients of performance measures. The t-values are presented in parentheses.

	Dependent Variables	
	(a) ROA	(b) Tobin's Q
Intercept	-.078 (-1.061)	-1.798 (-5.855)***
BDCOMP	.144 (1.560)	0.418 (1.088)
DIROWN	.039 (1.087)	.020 (.132)
LOGBDSIZE	-.042 (-1.724)*	0.384 (3.765)***
CEOD	.011 (.757)	-.110 (-1.842)*
DEBT	-.080 (-6.356)***	.886 (16.966)***
LOGSIZE	.020 (6.237)***	.049 (3.731)***
LOGAGE	.045 (1.934)*	.492 (5.096)***
Adjusted R2	0.302***	0.586***
F-Statistic	17.468***	54.887***

* At 10% level of significance, ** at 5% level of significance and *** at 1% level of significance respectively.

Discussion and Conclusion

This study examines the influence of board composition in the form of representation of outside independent directors on the firm's economic performance in Bangladesh. It is revealed that there is no significant relationship between board composition in the form of representation of outside independent directors and firm performance, implying that the outside independent directors cannot add potential economic value to the firm in Bangladesh. It is also revealed that the board size has a significant

negative influence on firm performance under accounting based performance measures, implying that there are information asymmetries between outside independent and other directors. Therefore, it is supportive that outside independent directors of Bangladeshi firms are not able to ensure the checks and balances of accountability and management activities as implied in the CGN in 2006. This is consistent with the Cadbury Report 1992 and the Higgs Report 2003 in the United Kingdom.

In our view, although independent outside directors, in general, do play an advisory role rather than adding economic value, there is a need for further exploration as to whether independent directors can provide effective judgmental contributions to firms. From the analysis we would like to conclude that the introduction of a hybrid regulation (such as CGN 2006) may not be an appropriate notification to achieve an intended accountability by the Bangladeshi corporate sector. Instead, there could be unique institutional and cultural factors which may be able to further explain Bangladeshi firms. From a policy perspective, we believe the findings of this study can be helpful for a provision of additional insight to the regulators in their quest to harmonize the corporate governance practices in Bangladesh with international best practices. We suggest for further studies to be carried out by increasing the sample size and the consideration of institutional, cultural and industry specific factors in order to identify other influences.

References

- Agrawal, A. & Knoeber, C. R., 1996. Firm's Performance and Mechanism to Control Agency Problems between Managers and Shareholders, *Journal of Financial and Quantitative Analysis*, 31 (3), 377-397.
- Ang, J. S., Cole, R. A., & Lin, J. W., 2000. Agency Cost and Ownership Structure, *The Journal of Finance*, 55 (1), 81-106.
- Ararat, M and Yurtoglu, B. B., 2006. Corporate Governance in Turkey: An Introduction to Special Issue, *Corporate Governance: An International Review*, 14 (4), 210-206.
- Asian Development Bank, 2000. *Corporate Governance and Finance in East Asia, A Study of Indonesia, Republic of Korea, Malaysia, Philippines and Thailand, A Consolidated Report*, Volume 1, Manila: The Asian Development Bank.
- Barnhart, S. & Rosenstein, S., 1998. Board Composition, Managerial Ownership, and Firm Performance: An Empirical Analysis, *The Financial Review*, 33 (4), 1-16.
- Barnhart, S. W., M. W. Marr, M. W., & Rosenstein, S., 1994. Firm Performance and Board Composition: Some New Evidence, *Managerial and Decision Economics*, 15 (4), 329-340.

- Bathala, C. T. & R. P. Rao, R. P., 1995. The Determinants of Board Composition: An Agency Theory Perspective, *Managerial and Decision Economics*, 16 (1), 59-69.
- Baysinger, B. D. & Butler, H. N., 1985. Corporate Governance and the Board of Directors: Performance Effects in Board Composition, *Journal of Law, Economics and Organization*, 1 (1), 101-124.
- Berle, A. A. & Means, G. C., 1932. *The Modern Corporations and Private Property*, Revised Edition, New York, Harcourt Brace and World Inc.
- Beasley, M. S., 1996. An Empirical Analysis of the Relation Between the Board of Director Composition and Financial Statement Fraud, *The Accounting Review*, 71 (4), 443-465.
- Brennan, N., 2006. Boards of Directors and Firm Performance: Is There an Expectations Gap? *Corporate Governance: An International Review*, 14 (6), 577-593.
- Brennan, N. & McDermott, M., 2004. Alternative Perspectives on Independence of Directors, *Corporate Governance*, 12 (3), 325-336.
- Brick, I. B., Palmon, O., & Wald, J. K., 2006. CEO Compensation, Director Compensation and Firm Performance: Evidence of Cronyism, *Journal of Corporate Finance*, 12 (3), 403-423.
- Brickley, J. A., Coles, J. L., & Terry, R. L., 1994. Outside Directors and the Adoption of Poison Pills, *Journal of Financial Economics*, 35 (3), 371-390.
- Byrd, J. W. & Hickman, K. A., 1992. Do Outside Directors Monitor Managers? Evidence from Tender Offer Bids, *Journal of Financial Economics*, 32 (2), 195-222.
- Cadbury, Sir A., 1992. *Committee on the Financial Aspects of Corporate Governance*, United Kingdom, London Stock Exchange.
- Chaganti, R. S., Mahajan, V., & Sharma, S., 1985. Corporate Board Size, Composition and Corporate Failures in the Retailing Industry, *Journal of Management Studies*, 22 (4), 400-417.
- Cho, D. & Kim, J., 2007. Outside Directors, Ownership Structure and Firm Profitability in Korea, *Corporate Governance: An International Review*, 15 (2), 239-250.
- Core, J. E., Holthausen, R. W., & Larcker, D. F., 1999. Corporate Governance, Chief Executive Officer Compensation and Firm Performance, *Journal of Financial Economics*, 51 (3), 371-406.
- Corporate Governance Notification (2006), Securities and Exchange Commission, Bangladesh.
- Cotter, J. F., Shivdasani, A., & Zenner, M. 1997. Do Outside Independent Directors Enhance Target Shareholders Wealth during Tender Offers? *Journal of Financial Economics*, 43 (2), 195-119.
- Daily, C. M., & Dalton, D. R., 1992. The Relationship between Governance Structure and Corporate Performance in Entrepreneurial Firms, *Journal of Business Venturing*, 7 (5), 375-386.

- Dalton, D. R., Daily, C. M., ; Ellstrand, A. E., & Johnson, L. J., 1998. Meta-Analytic Review of Board Composition, Leadership Structure and Financial Performance, *Strategic Management Journal*, 19 (3), 269-290.
- Dalton, D. R., & Daily, C. M., 1999. What's Wrong With Having Friends on the Board, *Across the Board*, 36 (3), 28-32.
- Davidson III, W. N., & Rowe, W., 2004. Intertemporal Endogeneity in Board Composition and Financial Performance, *Corporate Ownership and Control*, 1 (4), 49-60.
- Dayton, K. N., 1984. Corporate Governance: The Other Side of the Coins, *Harvard Business Review*, 62 (1), 34-47.
- Deegan, C., 2006. *Financial Accounting Theory*, Second Edition, Sydney, McGraw Hill Australia Pty Ltd.
- Del Guercio, D., Dann, L., & Partch, M., 2003. Governance and Boards of Directors in Closed-End Investment Companies, *Journal of Financial Economics*, 69, 111-152.
- Denis, D. K. & McConnell, J. K., 2003. International Corporate Governance, *Journal of Financial and Quantitative Analysis*, 38 (1), 1-36.
- Denis, D. J. & Sarin, A., 1999. Ownership and Board Structure in Publicly Traded Corporations, *Journal of Financial Economics*, 52 (2), 187-224.
- Fama, E. F., 1980. Agency Problem and the Theory of the Firm, *Journal of Political Economy*, 88 (2), 288-308.
- Farrar, J., 2005. *Corporate Governance: Theories, Principles and Practice*, 2nd Edition, South Melbourne, VIC, Oxford University Press.
- Fernandes, N., 2005., Board Compensation and Firm Performance: The Role of "Independent" Board Members, *ECGI Working Paper Series in Finance*, European Corporate Governance Institute.
- Fields, M. A., & Keys, P.Y., 2003. The Emergence of Corporate Governance from Wall St. to Main St.: Outside Directors, Board Diversity and Earnings Management, and Managerial Incentive to Bear Risk, *The Financial Review*, 38 (1), 1-24.
- Finkelstein, S., & Hambrick, D. C., 1996. *Strategic Leadership: Top Executives and Their Effects on Organization*, West Publishing Company, Minneapolis/ St. Paul.
- Flanagan, W., 1982. Board and Rooms, *FORBES Magazine*, New York, (October), 219-222.
- Fosberg, R. H., 1989. Outside Directors and Managerial Monitoring, *Akron Business and Economic Review*, 20 (2), 24-32.
- Franks, J., & Mayer, C., 1990., Takeover: Capital Market and Corporate Control: A Study of German, France and U.K., *Economic Policy*, 4 (10), 189-231.
- Gibson, M. S., 2003. Is Corporate Governance Ineffective in Emerging Markets? *Journal of Financial and Quantitative Analysis*, 38 (1), 231-250.

- Grace, M., Ireland, A., & Dunstan, K., 1995. Board Composition, Non-Executive Directors' Characteristics and Corporate Financial Performance, *Asia Pacific Journal of Accounting*, 2, 121-137.
- Guest, P. M., 2008. The Determinants of Board Size and Composition: Evidence from the UK, *Journal of Corporate Finance*, 14, 51-72.
- Gujarati, D., 2003. *Basic Econometrics*, 4th Ed, New York, McGraw-Hill.
- Hermalin, B. E., & Weisbach, M. S., 1991. The Effects of Board Composition and Direct Incentives on Firm Performance, *Financial Management*, 20 (4), 101-12.
- Hermalin, B. E., & Weisbach, M. S., 2003. Board of Directors as an Endogenously Determined Institution: A Survey of the Economic Literature, *Economic Policy Review*, 9 (1), 7-26.
- Higgs, D., 2003. *The Review of the Role and Effectiveness of Non-Executive Directors*, London, DTI.
- Hulbert, M., 2003. Outside Directors Don't Mean Outsize Returns, *New York Times*, 15th June, 37.
- Jensen, M. C., 1993. The Modern Industrial Revolution, Exit and the Failure of Internal Control Systems, *The Journal of Finance*, 48 (3), 831-880.
- Jensen, M. C., & Meckling, W. J., 1976. Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, *Journal of Financial Economics*, 3 (4), 305-360.
- Jonsson, E. I., 2005. The Role Model of the Board: A Preliminary Study of the Roles of Icelandic Boards, *Corporate Governance: An International Review*, 13 (5), 710-717.
- Judge, W. Q., Naoumova, I., & Koutzevol, N., 2003. Corporate Governance and Firm Performance in Russia: An Empirical Study, *Journal of World Business*, 38 (4), 385-396.
- Kaplan, R. S., & Kiron, D., 2004. Accounting Fraud at WorldCom, in Cummings, L and B. Millanta (eds), *Financial Accounting Theory and Practice*, 2nd Ed., Sydney: McGraw Hill Australia Pty Ltd.
- Kaplan, S. N. & Reishus, D., 1990. Outside Directorship and Corporate Performance, *Journal of Financial Economics*, 27 (2), 389-410.
- Kaymak, T., & Bektas, E., 2008. East Meets West? Board Characteristics in an Emerging Market: Evidence from Turkish Banks, *Corporate Governance: An International Review*, 16 (6), 550-561.
- Kesner, I. F., Victor, B., & Lamont, B. T., 1986. Board Composition and Commission of Illegal Acts: An Investigation of Fortune 500 Companies, *Academy of Management Journal*, 29 (4), 789-799.
- Kirkbride, J., & Letza, S., 2005. Can the Non-Executive Directors be an Effective Gatekeeper? The Possible Development of a Legal Framework of Accountability, *Corporate Governance: An International Review*, 13 (4), 542-550.

- Lawrence, A. T., 2004. The Collapse of Enron, in Cummings, L., & Millanta, B., (Editors), *Financial Accounting Theory and Practice*, 2nd Ed., McGraw Hill, Irwin.
- Luan, C., & Tang, M., 2007. Where is Independent Director Efficacy? *Corporate Governance: An International Review*, 15 (4), 636-643.
- McConnell, J. J., & Servaes, H., 1990. Additional Evidence on Equity Ownership and Corporate Value, *Journal of Financial Economics*, 27 (2), 595-612.
- Machold, S., & Vasudevan, A. K., 2004. Corporate Governance Models in Emerging Markets: The Case of India, *International Journal of Business Governance and Ethics*, 1 (1), 56-77.
- Main, A., 2002. HIH Used One Off Items to Reduce its Loss by \$ 157m, *The Australian Financial Review*, 22nd August.
- Majumdar, S. K. & Chhibber, P., 1999. Capital Structure and Performance: Evidence from a Transition Economy on an aspect of Corporate Governance, *Public Choice*, 98 (3-4), 287-305.
- McNulty, T. & Pettigrew, A., 1996. The Contribution, Power and Influence of Part-Time Board Members, *Corporate Governance: An International Review*, 3 (2), 160-79.
- Mizruchi, M. S., 2004. Berle and Means Revisited, The Governance and Power of U.S. Corporations, *Theory and Society*, 33, 579-617, Kluwer Academic Publishers.
- Mintzberg, H., 1984. Who Should Control the Corporation? *California Management Review*, 27 (1), 90-116.
- Nicholson, G., & Kiel, G., 2007., Can Directors Impact Performance? A Case Based Test of Three Theories of Corporate Governance, *Corporate Governance: An International Review*, 15 (4), 585-608.
- Ozawa, N., 2006. Corporate Governance and Investment Incentive of Japanese Firms, *Unpublished PhD. Dissertation*, University of Toronto, Canada.
- Parker, L. R., 2005. Corporate Crisis Down Under: Post-Enron Accounting Education and Research Inertia, *European Accounting Review*, 14 (2), 383-394.
- Patton, A., & Baker, J. C., 1987. Why Won't Directors Rock the Boat? *Harvard Business Review*, 65 (6), 10-12.
- Petra, S. T., 2005. Do Outside Independent Directors Strengthen Corporate Boards? *Corporate Governance*, 5 (1), 55-64.
- Ramsay, I., 2001. *Ramsay Report, Independence of Australian company auditors: Review of current Australian requirements and proposals for reform*, Australian Government Canberra, at www.treasury.gov.au, accessed 6 April 2010.
- Rashid, A., & Lodh, S. C., 2008, The Influence of Ownership Structures and Board Practices on Corporate Social Disclosures in Bangladesh, in Uddin, S. & Tsamenyi, M., (Editors), *Research in Accounting in Emerging Economies*,

- 8, 211-237.
- Rechner, P. L., & Dalton, R. D., 1986. Board Composition and Shareholders Wealth: An Empirical Assessment, *International Journal of Management*, 3 (2), 86-92.
- Rose, C., 2005. The Composition of Semi-Two Tier Corporate Boards and Firm Performance, *Corporate Governance: An International Review*, 13 (5), 691-701.
- Rosenstein, S., & Wyatt, J. G. 1990. Outside Directors, Board Independence and Shareholders Wealth, *Journal of Financial Economics*, 26 (2), 175-191.
- Rwegasira, K., 2000. Corporate Governance in Emerging Capital Markets: Whither Africa? *Corporate Governance: An International Review*, 8 (3), 258-267.
- Salmon, W. J., 1993. Crisis Prevention: How to Gear up Your Board, *Harvard Business Review*, 71 (1), 68-75.
- Sarkar, J., Sarkar, S., & Bhaumik, S. K., 1998. Does Ownership Always Matter? Evidence from Indian Banking Industry, *Journal of Comparative Economics*, 26 (2), 262-281.
- Securities Exchange Commission Bangladesh, 2006. *Corporate Governance Notification*
- Schellenger, M., Wood, D., & Tashakori, A., 1989. Board of director composition, shareholder wealth, and dividend policy, *Journal of Management*, 15 (3), 457-467.
- Shleifer, A., & Vishny, R. W., 1997. A Survey of Corporate Governance, *The Journal of Finance*, 52 (2), 737-783.
- Short, H., & Keasey, K., 1999. Managerial Ownership and Performance of Firm-Evidence from UK, *Journal of Corporate Finance*, 5, 79-101.
- Solomon, J., 2007. *Corporate Governance and Accountability*, Second Ed., Chichester, John Wiley and Sons Ltd.
- Tian, J. J., & Lau, C., 2001. Board Composition, Leadership Structure and Performance of Chinese Shareholding Companies, *Asia Pacific Journal of Management*, 18, 245-263.
- Weidenbaum, M. L., 1986. Updating the Corporate Board, *Journal of Business Strategy*, 7 (1), 77-83.
- Williamson, O. E., 1967. Hierarchical Control and Optimum Firm Size, *Journal of Political Economy*, 53 (2), 123-138.
- Xu, X., & Wang, Y., 1999. Ownership Structure and Corporate Governance in Chinese Stock Companies, *China Economic Review*, 10, 75-98.
- Yammitesri, J., & Lodh, S. C., 2004. Is Family Ownership a Pain or Gain to Firm Performance? *Journal of American Academy of Business*, 4 (1-2), 263-270.
- Yammitesri, J., Lodh, S. C., & Herath, S. K., 2006., Influence of Ownership Structure and Corporate Performance Pre-Crisis: Evidence from Thailand, *International Journal of Electronic Finance*, 1(2), 181-199.

- Zahra, S. A., & Pearce II, J. A., 1989. Board of Directors and Corporate Financial Performance: A Review and Integrative Model, *Journal of Management*, 15 (2), 291-334.
- Zahra, S. A., & Stanton, W. W., 1988. The Implications of Board of Directors' Composition for Corporate Strategy and Performance, *International Journal of Management*, 5 (2), 229-236.