THE BOARD OF DIRECTORS AND COMPANY PERFORMANCE IN EMERGING MARKETS

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How to cite this paper: Otman, K. (2019). The board of directors and company performance in emerging markets. *Corporate Law & Governance Review, 1*(2), 62-73. http://doi.org/10.22495/clgrv1i2p6

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ISSN Online: 2664-1542

Received: 02.07.2019
Accepted: 15.10.2019

JEL Classification: G3, G4
DOI: 10.22495/clgrv1i2p6

Abstract

This study investigates the board directors and their effect on company performance in emerging markets, particularly in the United Arab Emirates (UAE). Our findings robustly confirm that the UAE has adopted a board structure similar to that of Western countries. The results indicate the positive effects of leadership structure, board composition and audit committee independence on company performance. This is the first study to demonstrate that board structure is an important determinant in reducing agency problems and leading to improved company performance in unique ownership structures in emerging markets, such as exist in the UAE. It is also the first study to explore the board structure-firm performance relationship using a system-generalised method of moment's estimator for the UAE market. The regulatory and policy implications suggested in this research are significant, not only for the UAE but also for application to other emerging markets. In this context, clear insights are provided for policymakers, regulators, managers, investors, and researchers involved in emerging markets.

Keywords: The Board Directors, Emerging Markets, UAE, Firm Performance

Authors' individual contribution: The author is responsible for all the contributions to the paper according to CRediT (Contributor Roles Taxonomy) standards.

1. INTRODUCTION

There is a growing acceptance of the view that a board structure is an essential mechanism in promoting corporate decision making, strategic planning, and assisting in the achievement of high-level firm performance and value (Filatotchev & Wright, 2011; Klapper & Love, 2004; Rajagopalan & Zhang, 2008; Weir, Laing, & McKnight, 2002). In theory, it helps to solve the agency problems inherent in managing an organization (Hermalin & Weisbach, 2003; Jensen, 1993). A major reason for investigating the board of directors in emerging markets is to shed light on certain conditions, such as underdeveloped markets and weak legal systems (Kostyuk, Braendle, & Capizzi, 2017; Rabelo & Vasconcelos, 2002). In addition, these markets do not have features, such as long-established financial institution infrastructures, to cope with corporate governance issues, (McGee, 2010). La Porta et al. (2000) argue that emerging markets have traditionally been discounted in financial markets because of their weak governance.

In the Middle East and North Africa (MENA) region, the board of directors has undergone a substantial evolution in its rules and regulations, and the region is growing to emerge as a key destination for the global investment community (Amico, 2014; Sumpf et al., 2016). This is because the MENA region was overlooked by foreign investors due to the lack of corporate governance, transparency, and legal protection (Otman, 2018). In the UAE, 'governance structure is an emerging issue' (Obay, 2009, p. 44). Aljifri and Moustafa (2007) have recommended that corporate governance codes and internal control mechanisms should be developed by the policymakers in the UAE. In addition, corporate governance practice is still in the early stages, with a new, small stock market in the UAE.

Consequently, understanding corporate practices and improving standards are high on the agenda for the UAE, as well as many other developing countries. In the last three decades, the

UAE government has introduced reforms to restructure the economy. These reforms have included the development of many companies since the mid-1970s and two governmental stock exchanges, located in Dubai and Abu Dhabi, comprising the UAE stock market started in 2000 (Aljifri & Moustafa, 2007).

In 2006, the Hawkamah Corporate Governance Institute was launched in Dubai by the International Financial Centre (IFC) to encourage corporate governance codes in the UAE and other MENA countries (Shahram, 2008). There has been an attempt to incorporate accepted corporate governance principles in the UAE by initiating new rules (Travers, 2010). For instance, the Emirates Securities and Commodities Authority (ESCA) established the UAE Code of Corporate Governance for listed companies in 2007 based on the OECD Principles (Koldertsova, 2011; Pierce, 2008). In addition, the code of corporate governance was published in 2009 to improve corporate governance rules and regulations for the UAE Public Joint Stock Companies based on the OECD Principles; this replaced the corporate governance code that was established in 2007 (Bainbridge & Saliba, 2010).

Clearly, the board of directors is now becoming an important topic for the UAE government (Ramakrishnan, 2009). This view is consistent with Ahmad (2010), who has stated that board directors in the UAE has been given more attention as one of the effects of the global financial crisis. Since then, the UAE has begun to join the global economy through the application of international standards of corporate governance (Hussainey & Aljifri, 2012) because the board of directors plays an essential role in the difficult process of long-term transformation in all developing, transition and emerging-market countries (Oman, Fries, & Buiter, 2004; Otman, 2018).

The UAE is an emerging economic region that has been strongly influenced by the unique economic and social environment in the MENA region. It has witnessed phenomenal economic growth over a short period. The UAE has an open economy with a high per-capita income and a sizable annual trade surplus. Its wealth is based on its oil and gas output, and the fortunes of the economy fluctuate with the prices of those commodities (World Factbook, 2011). The economy of the UAE is the second largest in the MENA region, with a gross domestic product (GDP) of dirham (AED) 1.47 trillion in 2014. Therefore, this country has become a key focus for personal and institutional investors in the past decade (Obay, 2009).

The United Arab Emirates (UAE) as an emerging market differs from western nations in terms of law, business culture and unique characteristics of ownership structure, the rapid growth of the capital market in the UAE and the unique business environment of UAE listed firms. In recent years therefor, significant changes have been made to the regulation of corporate governance in the UAE. In early 2007, the Securities and Commodities Authority (SCA) introduced the UAE Code of Corporate Governance (SCA decision R/32 of 2007). In 2009, the SCA issued a revised Code of Corporate Governance to highlight the need to improve board of directors in the UAE. These changes were in response to the global financial crisis and the subsequent crisis in the UAE, known as the Dubai crisis, which happened in 2008.

This study is interested in addressing the gap in the governance literature in emerging markets such as the UAE by studying the following questions: Do firms in MENA region, such as the UAE, implement the same governance structure as firms in Western countries? Do board structures have implications for firm performance and market value in the UAE? In this study, the board structure was utilised as an independent variable. Firm performance was the dependent variable and was measured using return on equity (ROE), return on assets (ROA) and Tobin's Q ratio. In this regard, the results show that most listed companies have complied with the Code of Corporate Governance in the UAE. In addition, the results of regression indicate that most governance structure (board composition, board leadership, and audit committee independence) have positive effects on firm perform ance.

2. LEGAL OVERVIEW OF THE CORPORATIONS IN THE UAE

This section highlights the major regulations that cover the business of companies and are related to corporate governance, such as the UAE Commercial Companies Law No. 8 (1984) and the ES & CA (Emirates Securities & Commodities Authority) Disclosure and Transparency Regulation No. 3 (2000).

2.1. UAE Commercial Companies Law No. 8 (1984)

This law provides the basis for companies' practices in the UAE. It includes articles about Act 8 and has formed rules related to the board of directors' selection, composition, duties, and management processes. Article 95 emphasises that board size must be at least three members but no more than 15 members for a three-year term only, although any member can be elected for more than one period. Article 96 requires that the board of directors be elected at a general meeting of a company by secret ballot. Article 98 calls for a director to be allowed to be a director of only five companies, and no person can hold the chairman or vice-chairman position for more than two companies. Article 99 requires that a board elect a chairman and vice-chairman and that the chairman be a UAE national. Article 100 highlights that the majority of directors in a UAE company must be of Emirates nationality. Article 105 directs that a board meeting be held by the majority of members. In Article 111, the board of the company is accountable to shareholders for an act of fraud, abuse of power, violation of law and/or the corporation bylaws and wrongful management. According to Article 118, the company system determines the remuneration of the board to be no more than 10% of net profits after distributing profit worth at least 5% of the capital of the company to shareholders (Federal Law No. 8, 1984).

In Articles 190-198, the Corporation Act 1984 requires a company board to prepare financial records, including an income statement, balance sheet, and cash flow statement. In addition, at the end of the year, it should provide a report about company activity that is signed by the chairman of

the corporation as an integral part of the board director's report to the shareholder at the annual general meeting. Commercial Law 1984 calls for all companies to have an external auditor who is nominated at the general meeting of the company, and it also determines that the remuneration of the auditor for one year may be renewed for the same external auditor (Article 144). Moreover, the external auditor should audit company accounts and examine the balance sheet and financial income, noting the application of law and system of the company, and provide a report at the annual general meeting (Article 146). The external auditor must confirm the financial reports and highlight any irregularities to shareholders (Article 150).

2.2. ES & CA disclosure and transparency regulation

The regulation of ES & CA outlines the rules of disclosure concerning disclosure of ES & CA (Articles 8-16), disclosure of stock market (Articles 17-27) and disclosure of corporations (Articles 28-39) to improve transparency and enhance the accountability system. ES & CA decision No. 3 (2000) requires that the Authority ensures that disclosure and transparency are regulated in accordance with the law, regulations, and resolutions in the UAE (Article 8). The board may carry out an examination of market members regularly or upon request by a concerned party in order to determine the level of compliance with the law, and the rules and regulations in application (Article 9). Article 10 highlights that the Authority will not conduct commercial activities or have an interest in any particular project or own or issue any securities (ES & CA, 2000).

The regulation of ES & CA requires that the market monitors listed companies' responsibilities to disclose important matters and information and financial statements, and the timing of such publications, and ensures that the disclosures of companies are clear and reveal the facts that they express (Article 17). In addition, the market should issue the press notices necessary to ensure transparency of information and disclosure (Article 18). The members of the board in the market are not nominated in these positions if they are members of the board of that company or a financial or broker representative of a financial broker (Article 22). The market should provide the board with the balance sheet, the profit and loss account, and the annual financial statements audited by an accredited auditor within 90 days from the end of its financial year (Article 25) (ES & CA, 2000).

3. Analysis of corporate board practices in the UAE

This chapter provides an overview of the board structure in the UAE based on the rules of corporate governance. Thus, this section analyses the main articles in the UAE Code of Corporate Governance (Emirates Security and Commodity Authority (ES & CA) decision R/32 of 2007) and the ME published Ministerial Resolution No. 518 of 2009 concerning the structure of board director.

These include: board size; board composition; board meeting; leadership (chairman and CEO); board committee (nomination and remuneration committee, audit committee and other committees) as follows:

- ***Board size:*** Article No. 3(1) mentions that a company managed by a board of directors and the system of a company should determine the process of establishing the board and the number of members on the board. The new board should be elected by shareholders at a general meeting of the company.
- ***Board composition:*** Article No. 3(2) calls for a company to consider the balance in the formation of a board between executive and non-executive members. Further, at least one-third of board members should be independent, and the majority should be non-executive members. In addition, the board members should have sufficient qualifications, skills, and experience to conduct their duties.
- ***Board meeting:*** Article No. 3(6) indicates that a board of directors should set up at least one meeting every two months. All members should receive invitations at least one week from the date of the meeting based on the request of the chairman of the board or two members in this meeting. Moreover, the majority of members must attend the meeting.
- ***Leadership (chairman and CEO):*** Article No. 3 illustrates the system of a board in companies. Article No. 3(3) requires that the chairman of the board, director and senior manager must be different people. Article No. 6(2) indicates that the chairman must not be nominated to any committees of the board.
- ***Board committees:*** Article No. 6(1) requires that the board launch standing committees, such as an audit committee and a nomination and remuneration committee, to be directly associated with the company board.
- ***Nomination and remuneration committee:*** Article No. 6(2) describes the composition of the nomination and remuneration committee; it must comprise not less than three non-executive members. Further, it should include at least two independent members and one chair of the committee. The board of the company is responsible for selecting the members of this committee.
- ***Audit committee:*** Article No. 9 clarifies the duties of the audit committee. Article No. 9(1) mentions that this committee must comprise at least three non-executive members, and the majority of the members must be independent. In addition, one committee member should be an expert in accounting and financial affairs, or the company may appoint one member or more if there are an insufficient number of non-executive members in the company. In addition, Article No. 9(3) requires that the audit committee set up at least one meeting every three months.
- ***Remuneration of directors:*** Article No. 7 describes the system that determines the remuneration of a board with consideration of the Commercial Companies Law No. 8 of 1984. The company can give board remunerations as a percentage of company profits, but it must not exceed 10% of the net profit after deduction of expenses, depreciation, and reserves, and after the distribution of dividends to shareholders of no less than 5% of the company's capital.

The advantages of implementing the role board of directors in the UAE include: better management, leading to better company performance and results; protecting the interests of stakeholders (e.g., shareholders, employees and creditors); a transparent and organised mechanism to deal with conflicts of interest; boosting shareholder/investor confidence and potentially reducing investment risk; and fulfilling professional and social responsibilities. The purpose of implementing a corporate governance system is to align companies in the UAE with international standards, while the aim of this implementation is to protect shareholders' rights and promote their participation as stakeholders (Singh, 2010).

4. LITERATURE REVIEWS OF BOARD OF DIRECTORS AND COMPANY PERFORMANCE

In company boardrooms, among academics and legislators, and throughout businesses everywhere, governance structure is considered a mainstream concern for a company's essential framework (Claessens et al., 2000). Governance mechanisms are the policies and procedures employed by companies to solve corporate governance problems, and the application of these mechanisms depends on the corporate governance system (Weimer & Pape, 1999). Mechanisms for corporate governance can be divided into internal and external mechanisms (Gillan, 2006). The board of directors is considered internal governance mechanisms because their formation and management is solely dependent on decision-makers within the company (Agrawal & Knoeber, 1996). Four variables that were considered in this chapter are: board size, board leadership, board composition and audit committee independence (Khanchel El Mehdi, 2007).

4.1. Board size

There is considerable evidence to support that the size of the board plays an important role in corporate governance (Guest, 2009). Cheng et al. (2008) recognize that the importance of the board of director's size in corporate governance procedures is well established. The Cadbury Committee (1992) recommends an ideal board size of 8-10 members, with an equal number of executive and non-executive directors. Jensen (1993) argues that the optimum board size should be 7-8 directors. Based on the Codes of Corporate Governance in the UAE, the board of directors should consist of 3-12 members. Lipton and Lorsch (1992) argue that board size should be small and limited: 8-9 directors are optimal for coordination and communication, but if the board has more than 10 members, it is less likely that directors of the board will share their opinions and ideas.

A review of the literature concerning the relationship between corporate performance and board size shows mixed results. The majority of the studies indicate a negative relationship between board size and firm performance (Barnhart & Roseinste, 1998; Cheng et al., 2008; Eisenberg et al., 1998; Jensen, 1993; Yermack, 1996). A large board of directors suffers from coordination and communication problems because it is more difficult to arrange board meetings and reach consensus, which leads to slower and less efficient decision making (Guest, 2009). On the other hand, Kiel and Nicholson (2003) find that board size positively influences firm performance in Australia's listed companies. This is also supported by Chaganti et al. (1985) and Dalton et al. (1998) who believe that more expertise from a larger board can enhance decision making among board members and is more effective in promoting the success of the corporation. To test the above argument in the UAE companies, the following hypothesis was proposed:

H1: Board size has a significant relationship with the firm performance of listed companies in the UAE.

4.2. Leadership structure

The role separation of the CEO and the chairman of the board of directors are essential in alleviating issues of corporate governance practices in a firm (Brickley et al., 1997; Dalton et al., 1998; Dedman & Lin, 2002). Based on the agency theory, the CEO and chairman should be separate because the chairman cannot perform the duties without conflicts of personal interest (Jensen, 1993). Cadbury Committee (1992) believes that the role of the chairman should, in principle, be separate from that of the chief executive; if the two roles are combined, it represents a considerable concentration of power within the decision-making process. This view is supported by many other reports (Greenbury Committee, 1995; Higgs, 2003) and is also identified in the Codes of Corporate Governance in the UAE.

Several studies that examine the separation of the chairman of the board and CEO posit that agency problems are greater when the same person occupies both positions. Yermack (1996) states that firms have higher market value when the roles of CEO and chairman of the board are occupied by different people. Previous studies advocate separation in order to reduce opportunistic behaviour, which will, in turn, allow the board to exercise more control and avoid conflicts of interest (Daily & Dalton, 1994). In addition, separating the CEO and chairman roles allows the board of directors to be more effective in monitoring management's performance because agency costs are reduced and there is an emphasis on corporate transparency and accountability (Weir & Laing, 2001). To test the above argument in relation to the UAE context, the following hypothesis was proposed:

H2: Separate leadership has a positive significant relationship with the performance of listed companies in the UAE.

4.3. Board composition

Non-executive directors may help alleviate the agency problem by monitoring and controlling the opportunistic behaviour of management and by ensuring that managers are not the sole evaluators of their own performance (Baysinger & Hoskisson, 1990; Jensen & Meckling, 1976). Non-executive directors can be outside directors who offer checks and balances to protect the interests of shareholders, or they can be inside directors who participate directly in the day-to-day management of the firm (Klien, 2002; O'Sullivan & Wong, 1998; Petrovic, 2008; Wan & Ong, 2005). The Cadbury

Committee (1992) indicates that the presence of non-executives should be an effective method for enhancing board independence and firm performance. According to the UAE Code of Corporate Governance (2009), a majority of board members should be non-executive members.

Previous studies focusing on the relationship between non-executive directors and firm performance have mixed results. Chaganti et al. (1985), Dalton et al. (1998), Hermalin and Weisbach (1991), Rechner and Dalton (1989), Zahra and Stanton (1988) do not find any connection between firm performance and board composition (outside versus inside independent directors). However, according to Jensen and Meckling (1976), boards dominated by non-executive directors may help to mitigate agency problems by monitoring and controlling opportunistic behaviour of management. Based on the agency theory, the findings in some previous studies (Baysinger & Butler, 1985; Baysinger & Hoskisson, 1990; Hutchinson, 2002; Weisbach, 1988; Zahra & Pearce, 1989) support the proposition that board independence has a positive effect on firm performance. To test the above argument, the following hypothesis was proposed:

H3: Non-executive directors have a positive impact on firm performance of the listed companies in the UAE.

4.4. Audit committee independence

As a subcommittee of the board of directors, the audit committee is important for effective corporate governance (Abbott et al., 2000; Jensen & Meckling, 1976). The independent members of the audit committee can assist the principals in monitoring management activities and reducing potential problems if information is withheld (Beasley, 1996; Bradbury, 1990). According to the agency theory, there is a positive and significant association between the presence of an audit committee and the quality of financial statements (Beasley, 1996; Felo et al., 2003; Kelton & Yang, 2008). In this regard, the agency theory confirms that the presence of an audit committee on the board of directors is essential for providing support for the reliability of financial reports (McMullen, 1996). In the Codes of Corporate Governance UAE, audit committees should include at least three non-executive board members, at least two of which are independent members.

Empirical results regarding the relationship between audit committee independence and firm performance are mixed. The studies of both Klein (1998) and Mak and Kusnadi (2005) fail to find any significant relationship between audit committee independence and firm performance. However, Li et al. (2008) found that firms with a high proportion of independent audit committee members show improved performance. This falls in line with Aggarwal et al. (2009), Chan and Li (2008), Chidambaram and Brick (2008) and Erickson et al. (2005) who found that firms with a high number of independent audit committee members help to provide more effective monitoring of financial reporting and an improvement in firm performance. As suggested in the agency theory, the monitoring functions of independent audit committees mitigate agency problems (Hutchinson & Zain, 2009). To test the above argument in relation to the UAE context, the following hypothesis was proposed:

H4: Audit committee independence has a positive relationship with the firm performance of listed companies in the UAE.

5. METHODOLOGY DESIGN

5.1. Sample selection

The latest code on corporate governance practices established by the SCA in 2009 was the first to be implemented by UAE firms in 2010. Data from the Dubai Financial Market and the Abu Dhabi Securities Exchange was used over a two-year period from 2010 to 2011, given that 2010 was the first financial year in which best practices were implemented for corporate governance mechanisms. Some companies with no annual reports or corporate governance data were excluded from our sample; in addition, foreign companies, which are not obliged to report financial statements and are subject to different rules that do not follow the UAE Code of Corporate Governance, were excluded. Therefore, the study sample size was comprised of Emirates joint-stock listed for 80 of 128 companies. Financial performance and market value variables, corporate governance mechanism variables, and total assets and leverage variables were collected from DataStream, Mint Global and Orbis Bureau database.

5.2. Measurement of key variables

Four proxy measures were used for the board structure. Board size was measured by counting the number of appointed elected members on the board (Eisenberg et al., 1998; Yermack, 1996). In terms of leadership structure, zero indicates no separation of leadership, while one indicates a separation of chairman and CEO responsibilities (Haniffa & Hudaib, 2006). Board composition was calculated as the percentage of non-executives over the total number of members on the board (Baysinger & Butler, 1985; Rhoades et al., 2000). The value of audit committee independence was measured as the number of independent members compared to the total number of audit committee members (Chan & Li, 2008; Kirkpatrick, 2009).

The performance of the listed companies was determined using commonly used measures for accounting returns and market returns (Haat et al., 2008). ROE was calculated as net income divided by total equity to measure the profit a company has created with the money that shareholders have invested. ROA was measured by dividing a firm's net income by its total assets at the end of the year; this is an indicator of how profitable a company is relative to its total assets (Yan Lam & Kam Lee, 2008). Tobin's Q compares the ratio of a company's market value to the value of its assets (Weir et al., 2002). A firm's Tobin's Q is greater if it is more than 1; this Tobin's Q value implies that the firm is implementing a growth strategy and gives investors a positive perception regarding the firm's growth opportunities. In contrast, a ratio below 1 gives investors a perception of negative growth expectations and indicates that the firm should not reinvest in the same stock of assets.

Firm characteristics were employed in this research to control factors possibly affecting firm performance, such as firm size and leverage. The firm size variable is measured as log10 of the company's total assets (Himmelberg et al., 1999; Schmidt, 2003; Yan Lam & Kam Lee, 2008). In the present study, total liabilities were divided by total assets in order to measure the leverage of the firm (Alsaeed, 2006; Rashid et al., 2010).

5.3. Regression model specification

To test whether corporate governance mechanisms affect financial performance and market value, the following regression models were used:

$$ROA = \beta0 + \beta1\,(BSIZE) + \beta2\,(LDS) + \beta3\,(COMP) + \beta4\,(ACINDEP) + \beta5\,(SIZE) + \beta6\,(LEVG) + \varepsilon i \quad (1)$$

$$ROE = \beta0 + \beta1\,(BSIZE) + \beta2\,(LDS) + \beta3\,(COMP) + \beta4\,(ACINDEP) + \beta5\,(SIZE) + \beta6\,(LEVG) + \varepsilon i \quad (2)$$

$$Tobin's\ Q = \beta0 + \beta1\,(BSIZE) + \beta2\,(LDS) + \beta3\,(COMP) + \beta4\,(ACINDEP) + \beta5\,(SIZE) + \beta6\,(LEVG) + \varepsilon i \quad (3)$$

Where: the independent variables are BSIZE (board size); LDS (separate leadership); COMP (board composition); and ACINDEP (audit committee independence). The dependent variables are ROE (return on equity); ROA (return on assets); and Tobin's Q (market value). The control variables are SIZE (firm size) and LEVG (leverage).

6. Descriptive statistics

The descriptive statistics for the dependent, independent and control variables are reported in Table 1. The number of directors on the boards' (BSIZE) ranges from five to fifteen with a mean of 7.64 members. The mean leadership structure (LDS) is 0.80 and ranges from zero to one. The mean ratios of non-executive board and audit committee independence (COMP and ACINDEP) are 69% and 76%, respectively, with a minimum of 0.33 and 0.40, respectively, and a maximum of one for both variables. AS shown in Table 1, the ROA ratio ranges from -16.48% to 24.81%, with a mean of 3.69%. The ROE mean is 7.86%, with ratios ranging from -21.45% to 36.41%. The mean value for Tobin's Q is 1.08, with a minimum value of 0.08 and a maximum value of 3.15. Leverage (LEVG) ranges from 0.01 to 0.91, with a mean of 0.446. Finally, Table 1 below shows the total asset (SIZE) of the sampled firms. Concerning standard skewness and kurtosis statistics, it is clear that the presented data are not normally distributed.

Table 1. Descriptive statistics for all variables

Variable	*Mean*	*Std Dev.*	*Min.*	*Max.*	*Skewness*	*Kurtosis*
BSIZE	7.64	1.885	5	15	0.862	1.536
LDS	0.80	0.401	0.00	1	-1.514	0.296
COMP	0. 69	0.174	0.33	1	-0.522	-0.769
ACINDEP	0.76	0.149	0.40	1	0.585	-0.567
ROA	3.69	5.185	-16.48	24.81	-0.180	3.791
ROE	7.86	8.072	-21.45	36.41	-.594	2.529
Tobin's Q	1.08	0.515	0.08	3.15	1.446	2.970
LEVG	0.446	0.241	0.01	0.91	0.147	-0.829
SIZE	3.33	0.788	0.015	50.027	3.711	15.277

Note: BSIZE: total number of members on the board; LDS: Separate leadership: Dummy variables 0 for combined leadership and 1 for separate leadership; COMP: Board composition: Non-executive directors to number of directors; ACINDEP: Audit committees independence: Ratio of independent directors in the audit committee to total committee members; ROA: Return on assets; ROE: Return on equity; Tobin's Q: Market capitalisation plus the total company debt divided by total assets; SIZE: the size of the firm as measured by total assets; LEVG: total liabilities were divided by total assets.

The results indicate that most listed companies in the UAE comply with the Code of Corporate Governance and the UAE implement the same board structure as firms in Western countries such as the UK and Australia (Greenbury, 1995; Higgs, 2003; Cadbury, 1992; Hampel, 1998; ASX Corporate Governance Council, 2007). The findings suggest that some policies could be used to improve the accountability and transparency of managerial decision-making for shareholders and improve firm performance. The number of board members should be 7 to 9 members based on the findings of this research and the literature review, and not 3 to 12 members, as stated in the commercial law in the UAE. Non-executive directors should comprise at least 75% of the total number of directors, not simply a majority, as stated in the code, which does not identify a percentage. Independent directors should comprise at least 50% of the total number of directors, not one-third as confirmed in the code of the UAE. All audit committee members should be independent from the company; this is different from the requirements of the code, which states that at least two members should be independent. Listed companies should establish committees, such as risk management, and corporate governance committees.

7. ANALYSIS OF THE RELATIONSHIP BETWEEN BOARD GOVERNANCE AND COMPANY PERFORMANCE

7.1. GLS regression results

The results of the present study suggest that board size (BSIZE) can negatively, albeit not significantly, influence the firm performance of companies (ROA, ROE and Tobin's Q). This is not consistent with several researchers who find positive associations between board size and firm performance (Kiel &

Nicholson, 2003; Pearce & Zahra, 1992). However, the findings are consistent with conclusions drawn by other researchers (Cheng, 2008; Coles et al., 2008; Harris & Raviv, 2006; Raheja 2005) who find a similar negative relationship between large board size and firm performance. This study concludes that there is no significant relationship between board size and firm performance in listed companies in the UAE. Therefore, the first hypothesis (*H1*) of the study, that board size has a significant relationship with firm performance, was rejected.

Table 2. GLS regression with robust standard error of corporate governance mechanisms on firm performance

Variables	*ROA*		*ROE*		*Tobin's Q*	
	Coeff.	*P-value*	*Coeff.*	*P-value*	*Coeff.*	*P-value*
Constant	-9.41	0.004	-15.70	0.004	1.12	0.009
BSIZE	-0.19	0.304	-0.19	0.317	-0.01	0.427
LDS	4.14**	0.002	5.05**	0.012	-0.07	0.475
COMP	8.38***	0.000	12.15***	0.000	0.42*	0.080
ACINDEP	9.09***	0.001	13.36***	0.003	0.51**	0.030
SIZE	0.30	0.605	0.36	0.695	-0.33***	0.000
LEVG	-5.14***	0.003	5.10*	0.048	0.79***	0.000
R-squared (%)	35.40		32.77		30.04	
F-statistic	49.84***		88.55***		37.45***	

*Note: BSIZE: total number of members on the board; LDS: Separate leadership: Dummy variables 0 for combined leadership and 1 for separate leadership; COMP: Board composition: Non-executive directors to number of directors; ACINDEP: Audit committees independence: Ratio of independent directors in the audit committee to total committee members; ROA: Return on assets; ROE: Return on equity; Tobin's Q: Market capitalisation plus the total company debt divided by total assets; SIZE: the size of the firm as measured by total assets; LEVG: total liabilities were divided by total assets. ***, **, * indicates significance at the 1 percent, 5 percent and 10 percent levels respectively.*

Results presented in Table 2 indicate a statistically significant and positive relationship between financial performance (ROA and ROE) and separate leadership (LDS) at $p < 0.01$ and $p < 0.05$, respectively. These results are in agreement with those of Haniffa and Hudaib (2006), who found a significant relationship between separate leadership structure and the accounting-based measures of firm performance (ROA and ROE). However, in present research, Tobin's Q was not significantly related to separate leadership structure. This may be a result of leadership structure on its own not being recognised by the market. Furthermore, the present study results explain that different markets/systems around the world could affect the relationship between firm value and separate leadership structure. Consequently, the second hypothesis (*H2*) of the study, that separate leadership has a positively significant relationship with firm performance, was accepted.

The results also indicate that the relationship between firm performance (ROA, ROE, and Tobin's Q) and board composition (COMP) is significant and positive at $p < 0.01$, $p < 0.05$ and $p < 0.01$, respectively. The findings of this study, however, contradict those of other studies that examined the relationship between board composition and firm performance. For instance, Kiel and Nicholson (2003), Weir and Laing (2001) indicate a negative relationship between board composition and firm performance. Conversely, the present result is in agreement with Ezzamel and Watson (1993) who found a positive relationship between board composition and firm performance. Thus, the third hypothesis (*H3*) of the study, that board composition has a positive relationship with firm performance, was supported.

The findings presented in Table 2 show a statistically significant positive relationship between audit committee independence (ACINDEP) and firm performance, as indicated by ROA, ROE and Tobin's Q at $p < 0.01$, $p < 0.01$ and $p < 0.05$, respectively. The present study contradicts work by Mak and Kusnadi (2005) who found that having a majority of independent non-executive directors in the audit committee does not have a significant influence on firm performance. Nevertheless, the findings of the current study are consistent with those of Aggarwal et al. (2009), Chan and Li (2008), Erickson et al. (2005), Li et al. (2008) who found a significant positive relationship between firm performance and audit committee independence. The fourth hypothesis (*H4*) of the research was that audit committee independence has a positive relationship with firm performance. The results of the regression analysis support the *H4*.

7.2. Sensitivity analysis

In Table 3, the OLS regression model shows the same R-squared as the panel data regression analysis, indicating that OLS regression has the same strength as the main panel regression and the F-statistic of the regression models in Table 2. In addition, OLS regression reveals the same significant and insignificant relationships between board structure and firm performance. OLS regression confirms that the results of the panel data analysis are not sensitive to a change in the type of statistical test employed. Moreover, the selected panel data analysis is well suited to the examined data, given that there is no variation in the results between the primary analysis adopting the GLS regression and the findings of the pooled OLS regression. This sensitivity analysis shows general consistency with the overall findings. The results of using alternative model specifications do not alter the main inferences drawn from the reported results of the main model and the major statistical analysis. In this regard, the sensitivity analysis confirms the reliability of the results and findings.

Table 3. OLS regression with robust standard error of corporate governance mechanisms on firm performance

Variables	*ROA*		*ROE*		*Tobin's Q*	
	Coeff.	*P-value*	*Coeff.*	*P-value*	*Coeff.*	*P-value*
Constant	-11.17	0.000	-17.53	0.000	0.95	0.007
BSIZE	-0.12	0.417	-2.67	0.319	-0.12	0.491
LDS	4.02***	0.001	4.70***	0.009	-0.87	0.389
COMP	9.67***	0.000	13.58***	0.000	0.50**	0.016
ACINDEP	9.92***	0.000	14.48***	0.000	0.65***	0.003
SIZE	0.28	0.573	0.44	0.611	-0.32***	0.000
LEVG	-5.51***	0.000	4.38*	0.070	0.75***	0.000
R-squared (%)	35.60		32.91		30.26	
F-statistic	10.62***		13.23***		9.31***	

*Note: BSIZE: total number of members on the board; LDS: Separate leadership: Dummy variables 0 for combined leadership and 1 for separate leadership; COMP: Board composition: Non-executive directors to number of directors; ACINDEP: Audit committees independence: Ratio of independent directors in the audit committee to total committee members; ROA: Return on assets; ROE: Return on equity; Tobin's Q: Market capitalisation plus the total company debt divided by total assets; SIZE: the size of the firm as measured by total assets; LEVG: total liabilities were divided by total assets. ***, **, * indicates significance at the 1 percent, 5 percent and 10 percent levels respectively.*

8. CONCLUSION

This study investigates the effect of the board of directors on company performance in unique characteristics of emerging markets, such as the UAE. This research uncovered a number of noteworthy findings that have implications for scholars and practitioners interested in corporate governance issues in the context of emerging markets, in particular UAE. The findings are robust to confirm that most of these companies have complied with the code of corporate governance and the UAE implemented the board structure similar to that in Western countries such as the UK and Australia (Greenbury, 1995; Higgs, 2003; Cadbury, 1992; Hampel, 1998; ASX Corporate Governance Council, 2007). According to the regression results, there is a positive and significant relationship between board structure and company performance. However, it can be concluded from the study findings that there is no significant relationship between board size and firm performance. Importantly, the new evidence indicates that companies with better board structure are expected to have higher-quality management which results in better decision making and enhanced company performance in the UAE. For these reasons, there is strong evidence to support that the board of directors could mitigate agency conflict, which is likely to bring about improvements in company performance.

In addition, the results have significant implications, which may improve the accountability and transparency of managerial decision making for shareholders and enhance corporate performance in emerging markets such as the UAE. Indeed, good board structure is an effective mechanism for alleviating agency conflicts and serving as internal control system to monitor management and emerging markets countries thus, need to take effective measures to improve the functioning of these mechanisms. The evidence on the association between board of directors and company performance could help policymakers and regulators to develop new policies and establish a competitive legal and regulatory infrastructure to attract investors. The board of directors is one of the crucial, initial elements to build investor confidence for attracting foreign and local investment, to expand the trade relationship and establish stability of companies in emerging markets in particular UAE.

This paper is important for future research because it makes contribution to the corporate governance literature in general and the UAE in particular. It explores the corporate governance practices in listed companies in the DFM and ADX in the UAE. Previous studies have examined corporate governance in both developed and developing nations, as well as the relationship between corporate governance practice and firm performance in developed countries, but few have studied this relationship in developing countries such as the MENA region. Therefore, this study represents an important contribution to the corporate governance literature in the UAE and the MENA region in general.

However, the study is not without limitations, such as the number of variables included and the time frame of the study. First, the focus was restricted to the governance mechanism variables of board size, leadership structure, board composition, and audit committee independence. Thus, there is a need to examine other corporate governance mechanisms, such as: ownership structure, board meetings and board committees; CEO performance, skills and tenure; executive remuneration and incentives for management; and staff tenure and qualifications. Second, the study used data from 2010 to 2011, and future research would benefit from examining corporate governance practices and firm performance over a longer period of time. Finally, aside from the financial performance analysis in this study, there is room for future research to investigate how corporate governance impacts economic, social and environmental performance.

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