

**THE ROLE OF CEO, BOARD COMPOSITION AND FIRM PERFORMANCE:
AN EMPIRICAL STUDY OF LISTED COMPANIES IN BANGLADESH**

Md. Abdur Rouf

Senior Lecture of Accounting, Department of School of Business,
Asian university of Bangladesh

ABSTRACT

This study investigates the role of CEO, board independent director as well as separate elements of corporate governance on firm performance for the listed non-financial companies in Dhaka Stock Exchange (DSE) 2008. Specific objective of this research is to examine the relationship between separation of CEO and the proportion of independent directors on firm performance as measured by return on assets (ROA) and return on equity (ROE). This paper is based on a sample of 93 listed companies and Used OLS as a method of estimation. The results suggest a positive association between ROA and separation of chief executive officer and between board independent director and ROA. The results further reveal a positive association between ROE and chief executive officer as well as board independent director. However, ownership structure is negative association with the firm performance measures (ROA and ROE) but not significant.

Keywords : Role of CEO, Corporate Governance, Firm Performance, DSE. .

1. INTRODUCTION

The chief executive officer (CEO) plays an important role in the operation of a company. It oversees top management and is entrusted with the responsibility of monitoring and supervising the company's resources and operation. Therefore, the CEO is collectively seen as a term of individuals with fiduciary responsibilities of leading and directing a firm, with the primary objective of protecting the firm's shareholders' interest (Abdullah, S. N., 2004). There are three critical CEO roles that have been identified and studied by a variety of theoretical perspectives inclusive of service roles, control roles and strategic roles (Boyd, B.K.,1995; Goyal, V., and C. Park.,2002).

This study also extends the literature on the interaction between corporate governance and the structure of managerial compensation. For the corporate governance strand of research show that improved governance structures (such as a higher proportion of independent board members and separation of the CEO and Chairman positions) enhances the positive association between pay dispersion and firm performance. Thus, corporate governance and managerial pay dispersion are complementary and perhaps mutually enhancing mechanisms for strengthening firm performance. In the context of shareholders-managers agency costs provide evidence suggesting that managerial pay dispersion can potentially mitigate agency costs in firms that are difficult to monitor. More generally, the study supports the notion that the structure of executive compensation affects agency costs and firm performance.

Goyal and Park (2002), whose results show that the CEO turnover is significantly less sensitive to firm performance when the positions are combined. In contrast, Brickley, Coles, and Jarrell (1997) find no evidence showing that combined leadership structure leads to poorer performance. The authors suggest that the title separation does not only bring benefit, but also incurs cost, which includes the agency cost of monitoring the non-CEO board chairman, information sharing cost between the CEO and the chairman, and incentive costs associated with a succession process in which CEOs are promised the chairman title (Brickley, et al., 1997). The cost induced may offset the advantage that a separate CEO-Chairman leadership offers. The corporate governance literature emphasizes the independent directors as an efficient way to mitigate agency problems and to improve the quality of corporate governance. In theory it is expected that the outside directors represent the minority shareholder's best interest since the failure of fulfilling their duties may incur an extensive reputation cost (Fama and Jensen, 1983).

The authors suggest increasing the proportion of outside directors is an effective way to reduce financial fraud since the outsiders tend to monitor management more closely and thus assist to deter frauds (Chen, et al., 2006). Karamanou and Vafeas (2005), Firth, et al. (2007), and Lai and Tam (2007) all indicate that firms with boards dominated by independent directors have better quality of accounting information. Unfortunately, the findings about the relationship between the percentage of independent directors on the board and the firm performance are mixed.

2. STUDY OBJECTIVES:

The overall objective of examining the relationship between corporate governance mechanisms and firm financial performance in Bangladesh, this study had several specific objectives. In particular the study sought to:

1. Examine whether or not the separation of the posts of CEO and Board Chair is of any value in the promotion of firm performance.
2. Examine the relationship between board composition structure and firm performance.

3. LITERATURE REVIEW AND HYPOTHESES DEVELOP:

3.1 Separation of CEO:

Within the context of corporate governance, the central issue often discussed is whether the chair of the board of directors and CEO positions should be held by different persons (dual leadership structure) or by one person (unitary leadership structure). Jensen (1993) shows a deep concern that a lack of independent leadership creates a difficulty for boards to respond to failure in top management. In this regard, Kajola and Sunday (2008) also argue that concentration of decision management and decision control in one individual hinders boards' effectiveness in monitoring top management. It is argued that there is conflict of interest and higher agency costs when the same person occupies the two positions (Brickley et al, 1997) and this leads to the suggestion that the two positions should be occupied by two persons. Yermack (1996) and Sanda et al, (2005) show that firms are more valuable when the CEO and the chairman of the board positions are occupied by different persons. However, (Daily and Dalton, 1992; Kajola and Sunday, 2008) does not find a positive relation on the separation of the position of CEO and board chair. Based upon the literature, the relationship between CEO duality and firm performance will be investigated in the study and tested the following hypothesis:

H₁: The separation of CEO and Board chair positions has a positive relationship with firm performance.

3.2 Board Independent Director:

A board is generally composed of inside and outside members. Inside members are selected from among the executive officers of a firm. Outside directors are members whose only affiliation with the firm is their directorship. The role independent director on the board of directors is to effectively monitor and control firm activities in reducing opportunistic managerial behaviors and expropriation of firm resources. The proportion of independent directors is positively correlated to the firm performance (Agrawal and Knoeber, 1996). Increasing the level of the proportion of independent directors should simultaneously increase firm performance as they are more effective monitors of managers (Mehran, H., 1995). Some researchers found that although the proportion of independent directors on the board is high, the level of board independence and professionalism is not necessarily good (Chen, et al. 2005). The relationship between the proportion of independent director and firm performance was found to be negative (Klein, 1998; Kajola and Sunday, 2008; Yermack, 1996). It has been further argued that there is no relationship between the proportion of independent directors and superior firm performance (Hermalin and Weisbach, 2001). Based upon the literature, the relationship between proportion of independent directors and value of firm will be investigated in the study and tested the following hypothesis:

H₂: Independent directors have a positive relationship with the firm performance.

4. METHODOLOGY

4.1 Sample Design

The sample data have been collected from the Dhaka stock exchanges seminar library for the period 2008. 93 listed non-financial companies from stock exchange have been selected on an available basis covering all sectors. The data in the current study about corporate governance and firm performance consists of internal corporate governance variables and control variables. The internal corporate governance mechanisms are the roles of separation of CEO and independent director. In addition, the control variables in this study consist of board size, board audit committee, ownership structure, firm size. The method of analysis is that of multiple regressions and the method of estimation is Ordinary Least Squares (OLS).

4.2. Model Specification

The economic model used in the study (which was in line with what is mostly found in the literature) is given as:

$$Y = \beta_0 + \beta \text{Fit} + \text{eit} \quad (1)$$

Where, Y is the dependent variable. β_0 is constant, β is the coefficient of the explanatory variable (corporate governance mechanisms), Fit is the explanatory variable and eit is the error term (assumed to have zero mean and independent across time period). It is important to state that this study employs two financial ratios (ROA and ROE) to measure the firm performance. By adopting the economic model as in equation (1) above specifically to this study, equation (2) below evolves.

$$\text{VF} = \beta_0 + \beta_1 \text{SCEO} + \beta_2 \text{BIND} + \beta_3 \text{BSIZE} + \beta_4 \text{BACOM} + \beta_5 \text{OS} + \beta_6 \text{TASSET} + \beta_7 \text{TSALES} + \text{eit} \quad (2)$$

The variables that will be used in the analysis are as follows:-

Dependent Variables:

- ROA = Return on Assets (Net profit after tax divided by total assets) ×100
- ROE = Return on Equity (Net profit after tax divided by total equity) ×100

Independent Variables:

- SCEO = Separation of CEO- Value zero (0) for if the same person occupies the post of the chairman and the chief executive and one (1) for otherwise.
- BIND = Board Independent- Proportion of independent directors sitting on the board
- BSIZE = Board size- Total number of directors on the board
- BACOM = Board audit committee, 1 for presence or 0 for others
- OST = Ownership structure- Percentage of equity owned by the insiders to all equity of the firm
- TASSET = Total assets of the firm.
- TSALES = Total Sales of the firm.

5. RESULTS AND DISCUSSION

Table-1: Descriptive Statistics

Variables	Mean	Median	Std. Deviation	Minimum	Maximum
ROA	2.725	2.100	16.777	-120.940	72.110
ROE	4.552	5.870	29.703	-120.940	71.420
SCEO	0.73	1.000	.446	0	1
BIND	10.570	13.00	9.038	0	38.
BSIZE	6.680	6.000	2.054	3	13.
BACOM	0.680	1.000	0.470	0	1
OST	21.710	19.300	19.761	0	66
TASSET	27020.802	4813.130	66374.166	56.950	378056.50
TSALES	18318.834	4817.380	58766.099	.000	441016.70

5.1 Result of Descriptive Statistics

Table-1 shows the descriptive statistics of all the used in the study. The mean ROA of the sampled firms is about 2.73% and the mean ROE is 4.55%. The results indicate that on average 2.7 and 4.55 profits was earned of the sample firms. The result also indicates that 73% have separate persons occupying the post of the chief executive and the board chair, while 17% have the same person occupying the two posts. The

average independent directors are 10.57% with standard deviation 13%. This indicates that independent directors approximately 11% of the board. The average board size is 6.68 with a standard deviation of 2.05 and it ranges 3 to 13 members. A majority of the firms (68%) have audit committee of the sample firms. The results also indicate that on average 22% Percentage of equity owned by the insiders to all equity of the sample firms.

Table 2a- Correlations (Person) ROA as a firm performance (N=93)

VARIABLES	ROA	SCEO	IND	BSIZE	BACOM	BOS	TASSET	TSALES
ROA	1.000	0.325	0.324	0.047	0.159	-0.179	0.018	0.086
SCEO	0.325	1.000	0.446	0.213	0.412	-0.321	0.105	0.161
BIND	0.324	0.446	1.000	0.217	0.338	-0.245	0.161	0.214
BSIZE	0.047	0.213	0.217	1.000	0.094	-0.248	0.295	0.232
BACOM	0.159	0.412	0.338	0.094	1.000	-0.376	0.197	0.181
OST	-.179	-.321	-.245	-.248	-.376	1.000	-0.281	-0.005
TASSET	0.018	.105	0.161	0.295	0.197	-0.281	1.000	0.580
TSALE	0.086	.161	0.214	0.232	0.181	-0.005	0.580	1.000
Sig(1-tailed)ROA	-	0.001	0.001	0.328	0.064	0.043	0.433	0.206
SCEO	0.001	-	0.000	0.020	0.000	0.001	0.105	0.161
BIND	0.001	0.000	-	0.018	0.000	0.009	0.062	0.020
BSIZE	0.328	0.020	0.018	-	0.094	0.008	0.002	0.012
BACOM	0.064	0.000	0.000	0.094	-	0.000	0.029	0.041
OST	0.043	0.001	0.009	0.008	0.000	-	0.003	0.479
TASSET	0.433	0.105	0.062	0.002	0.029	0.003	-	0.000
TSALE	0.206	0.161	0.020	0.012	0.041	0.479	0.000	-

Table2b- Correlations (Person) ROE as a firm performance (N=93)

VARIABLES	ROE	SCEO	IND	BSIZE	BACOM	BOS	TASSET	TSALES
ROA	1.000	0.488	0.379	0.102	0.175	-0.210	0.118	0.141
SCEO	0.488	1.000	0.446	0.213	0.412	-0.321	0.105	0.161
BIND	0.379	0.446	1.000	0.217	0.338	-0.245	0.161	0.214
BSIZE	0.102	0.213	0.217	1.000	0.094	-0.248	0.295	0.232
BACOM	0.175	0.412	0.338	0.094	1.000	-0.376	0.197	0.181
OST	-0.210	-0.321	-0.245	-0.248	-0.376	1.000	-0.281	-0.005
TASSET	0.118	0.105	0.161	0.295	0.197	-0.281	1.000	0.580
TSALE	0.141	0.161	0.214	0.232	0.181	-0.005	0.580	1.000
Sig(1-tailed)ROA	-	0.000	0.000	0.165	0.047	0.022	0.0130	0.088
SCEO	0.000	-	0.000	0.020	0.000	0.001	0.159	0.061
BIND	0.000	0.000	-	0.018	0.000	0.009	0.062	0.020
BSIZE	0.165	0.020	0.018	-	0.186	0.008	0.002	0.012
BACOM	0.047	0.000	0.000	0.186	-	0.000	0.029	0.041
OST	0.022	0.001	0.009	0.008	0.000	-	0.003	0.479
TASSET	0.130	0.159	0.062	0.002	0.029	0.003	-	0.000
TSALE	0.088	0.061	0.020	0.012	0.041	0.479	0.000	-

Table 3: Multiple Regression Analysis (N=93)

Variables	ROA			ROE		
	Beta Coefficient	t-value	Sig.	Beta Coefficient	t-value	Sig.
SCEO	.215	1.795	.076*	.418	3.775	.000***
BIND	.225	1.955	.054*	.209	1.965	.053*
BACOM	-.037	-.314	.755	-.102	-.945	.348
BSIZE	-.062	-.575	.567	-.059	-.588	.558
OST	-.109	-.914	.364	-.067	-.613	.541
TASSET	-.090	-.682	.497	.035	.290	.773
TSALE	.076	.587	.558	.041	.339	.735
R Square = 0.149 ; Adjusted R square = 0.089; F value =2.289 ; F significance = 0.035; Durbin Watson =1.908			R Square = 0.283; Adjusted R square = 0.224; F value = 4.804 ; F significance = 0.000; Durbin Watson =2.040			
* P<0.1, two-tailed, *** P<0.01, two-tailed						

5.2 Result of Correlation Analysis:

Tables 2a and 2b present the correlations among the variables. Table 2a indicates that ROA is positively correlated with separation chief executive officer and is significant (sig.0.001). Similar results appear for the board independent director. ROA has a positive relationship with board audit committee and is significant (sig.0.064).one the other hand, ROA has negative relationship with ownership structure and is significant (sig.0.043). However, ROA has a positive relationship with board size, total assets and total sales but not significant respectively (sig.0.328; 0.433; 0.206).

Table 3b also indicates that ROE is positively correlated with the separation chief executive officer and board independent director and is significant (sig.0.000). ROE has a positive relationship with board audit committee and total sales and is significant respectively (sig.0.047; 0.088).one the other hand, ROA has negative relationship with ownership structure and is significant (sig.0.022). However, ROE also has a positive relationship with board size and total assets but not significant.

5.3 Result of Regression Analysis:

Table-3: shows the results of the multiple regression analysis in our study. Regression has been used in much previous research (Agrawal and Knoeber, 1996; Kajola and Sunday, O., 2008; Boyd,B.K.,1995;Chen, et al.2005; Yermac (1996) and Sanda et al, 2005).The table shows the association between firm performance(ROA and ROE) and experimental variables. The coefficient of coordination R-square, F ratio, beta coefficients and t-statistics for the regression model and summarized results of the dependent variable on the explanatory variables can be seen in the table-3. The result indicates an R-square of 0.149, and an F value of 2.289, which is significant at the 0.035 levels of ROA and R-square of 0.283, and an F value of 4.804, which is significant at the 0.000 levels of ROE. Both of these values suggest that a significant percentage of the firm performance (ROA and ROE) can be explained by the set of independent variables.

The results of the multiple regressions and indicates a positive relationship between ROA and separation of chief executive officer at 10% level of significant and between ROE and separation of chief executive officer at 1% level of significant also. This outcome has the support of Yermac (1996) and Sanda et al,

(2005); Cyril, H. and Ponnu (2008). This result is dissimilar to Daily and Dalton, (1992); Kajola and Sunday, (2008).

The relationship between the ROA and board independent director is positive and statistically significant at 10% level and ROE with board independent director is also positively significant at 10% level. This result is similar with Agrawal and Knoeber, (1996); Mehran, H., (1995). This is opposite with Klein, (1998); Yermack, (1996) Chen, et al. (2005); Kajola and Sunday, (2008).

6. CONCLUSION AND SUGGESTION OF FURTHER STUDY

This paper provides empirical evidence on the nature of corporate governance through separation of CEO and board independent director in the context of Bangladesh. A sample size of 93 non-financial firms listed on the Dhaka Stock Exchange (DSE) in 2008 is used. Panel data methodology is employed; the method of analysis is multiple regressions and the method of regression is OLS. The results presented, in this study suggest that, for Bangladeshi non-financial companies separation of CEO and firm performance is positively related and board independent director also positively significant with firm performance.

There are a number of limitations of this study as well. First limitation of the study is used only non-financial companies as a sample. So, the results may not extend across all companies in Bangladesh. Second, the study considers data of only one year. The results may differ across different years if multiple years are considered for analysis. Regarding future line of research, efforts should be put at increasing the sample size and firm performance, particularly the inclusion Tobin's Q, return on investment(ROI), net profit margin(NPM), Sales growth.

REFERENCE:

Abdullah SN(2006). Board structure and ownership in Malaysia: The case of distressed listed companies, Emerald group publishing limited, ISSN-1472-0701, Vol.5, No.5, pp.582-594

Agrawal A, Knoeber C(1996). Firm performance and mechanisms to control agency problems between managers and shareholders, Journal of Financial and Quantitative Analysis, vol. 31, no. 3, pp. 377-397

Boyd BK(1995). CEO duality and firm performance: a contingency model, Strategic Management Journal, Vol.16, pp 301-312

Brickley JA, Coles JL, Jarrell G(1997). Leadership Structure: Separating the CEO and Chairman of the Board, Journal of Corporate Finance, 3(3), 189-220.

Chen K, Elder R, Hsieh M (2005). Corporate governance and earnings management: the implications of corporate governance best-practice principles for Taiwanese listed companies, working paper, National Cheng Kung University, Taiwan, available at: <http://scholar.google.com/scholar>

Chen G, Firth DN, Gao, Rui OM (2006). Ownership, corporate governance, and fraud: Evidence from China, Journal of Corporate Finance 12: 424-448

Cyril H, Ponnu (2008).Corporate governance structure and the performance of Malaysian public listed companies, International Review of Business Research Papers Vol.4 No.2 pp.217-230

Daily CM, Dalton DR(1992).The Relationship between Governance Structure and Corporate Performance in Entrepreneurial Firms, Journal of Business Venturing, 7(5), 375-386.

Fama E, Jensen MC(1983). Separation of ownership and control, Journal of Law and Economics 26: 301-325

Firth M, Fung P, Rui O (2007). Ownership, two-tier board structure, and the informativeness of earnings: evidence from China, Journal of Accounting and Public Policy 26: 463-496

Goyal V, Park C (2002).Board leadership structure and CEO turnover, Journal of Corporate finance 8: 49-66

Hermalin B, Weisbach M(1991).The effects of board composition and direct incentives on firm performance, Financial Management, vol. 20, no. 4, pp. 101-112

Jensen MC(1993). The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems, Journal of Finance, 48(3), 832-880

Karamanou I, Vafeas N(2005).The association between corporate boards, audit committees, and management earnings forecasts: an empirical analysis, Journal of Accounting Research 43: 453–486

Klein A (1998). Firm performance and board committee structure, Journal of Law and Economics, Vol. 41, pp 275- 303

Kajola and Sunday O(2008). Corporate governance and firm performance: The case of Nigerian listed firms, European Journal of Economics, Finance and Administrative Sciences, Issue 14,<http://www.eurojournals.com>

Lai L, Tam H(2007).Independent directors and the propensity to smooth earnings: A study of corporate governance in China, The Business Review 7: 328-335

Mehran H(1995). Executive compensation structure, ownership and firm performance, Journal of Financial Economics, Vol. 38, pp 163- 184

Sanda AU, Mikailu AS, Garba T(2005). Corporate governance mechanisms and firm financial performance in Nigeria, AERC Research Paper 149, Nairobi

Yermack D(1996). Higher market valuation of companies with a small board of directors, Journal of Financial Economics, Vol.40, pp 185- 211
