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THE IMPACT OF CORPORATE OWNERSHIP ON UNITARY BOARD INDEPENDENCE: EVIDENCE FROM BANGLADESH

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ABSTRACT

Board independence is an important corporate governance element and without good governance it is impossible to form a unitary board system. After the crash in Bangladesh in 2011, it becomes a major issue for public listed companies in Bangladesh to follow a unitary system. This study addresses the issue by examining statistical relationship between corporate ownership and board independence. Descriptive statistics, bivariate analysis and multiple regression techniques are applied in analyzing the attitudes of family, public and institutional owners towards board composition, the degree of influence each type of owner has on board and the presence goes beyond board independence. The results show that board are lacking in independence and family ownership has a significant, negative effect on board independence, in which the results indicate that public and institutional ownership have a positive, nonsignificant influence. It is recommended for professionals to be included on board and that nonexecutive directors should be selected by a search committee to ensure that their competency matches the firm needs. It is further recommended that there should be a minimum of two independent directors and that management should be motivated, in line with the positive reinforcement theory. The German or Japanese model (two-tier board) can also be considered. This study also suggests that regulators should rethink how an independent and professional board can be formed when the barrier of concentrated ownership is removed.

Keywords: *Corporate governance, board independence, family ownership, corporate ownership, Bangladesh*

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INTRODUCTION

An independent corporate board is a prerequisite for good corporate governance, especially for unitary board (one-tier board), where board is the highest authority. The past records of corporate scandal such as Enron, WorldCom, Waste Management, Tyco show that management is involved in malpractice and these occurred with the connivance of the board. This has raised an issue regarding board monitoring effectiveness (Raphaelson & Wahlen, 2004). The monitoring mechanism is insufficient and dominant individuals or cliques have overwhelming influence on board members (Rose, 2005). The scandals underline the importance of good governance[1], leading to call for boardroom reform and attract the attention of stakeholders, policymakers, researchers, regulators and professional bodies. Among the reform agendas, board independence is one of particular interest (Rashid, 2015).

The recent capital market crash[2] has seriously eroded the stakeholders' confidence level. The Probe Committee inquiry report[3] states that malpractice occurs at firm level, market level and regulator level. Irregularities in private placement, book building, direct listing, bonus issue, right issue, asset revaluation, tax deferral, serial trading, management earnings, false reporting and other practices are identified by the Probe Committee (2011) as the cause of share price bubble. The irregularities create a negative impression among stakeholders about board monitoring capability and independence of the board. The World Bank report (2009) on corporate governance in Bangladesh states that greater independence is required in boardroom. The majority of listed companies' ownership is in the hand of family members (Hasan, Abdul Rahman & Hossain, 2014). The company senior management who were involved in past scandals took control over the board with a deliberate view to meet target by fraudulent financial statement, as if they meet stakeholder expectation (Rose, 2005). Corporate board should, therefore, be on their guard and employ a proactive approach to prevent fraudulent activities. When stakeholders have limited information, opportunistic directors have the room to manipulate financial

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1 Djodat, N., & Nguyen, T. 2008. Corporate governance disclosure in emerging markets. Downloaded from: https://www.uni-ulm.de/fileadmin/website_uni_ulm/mawi2/forschung/preprint-server/2008/0807_corporate_governance.pdf

2 Largest crash (2011) of capital market in corporate history of Bangladesh

3 This report is prepared by Probe Committee - 2011

report (Hasan, Hossain & Abdul Rahman, 2014a). In Bangladesh, the percentage of discretionary accruals in financial reporting is very high (Hasan, Abdul Rahman & Hossain, 2014b), which leads to suspicion over creative accounting.

Corporate governance guidelines for listed companies were issued by the Bangladesh Securities and Exchange Commission (BSEC) in 2006 and revised in 2012, after the market crash. Bangladeshi companies follow an Anglo-American model (one-tier board) where the board is the highest governing body. All corporate governance models revolve around four core principles, namely fairness, accountability, responsibility and transparency. The specific characteristics of independent director are mentioned in both guidelines. An independent and effective board is crucial for good governance. It also generates corporate revenue by the buildup of trustworthiness and corporate reputation among existing and potential stakeholders (Hasan, Omar & Handley-Schacler, 2015a). Besides, firm corporate governance level has a positive and significant relationship with market capitalisation (Hasan & Omar, 2015). The board does not only monitor management activities but also provide the management with strategic guidelines to review and ratify management proposals (Jonsson, 2005). Due to legally vested responsibility, the board should spot problems early and "blow the whistle" (Salmon, 1993).

Board independence was recognised as an issue upon the market crash (2011) in Bangladesh. The challenge of forming an independent and effective board depends on ownership structure. This study strives to address this issue. The purpose of this study is to provide empirical evidence regarding the role of corporate ownership in forming an independent and effective board.

LITERATURE REVIEW

The previous works on corporate governance (CG) cover issues such as CG structures, CG codes and the relationship between CG and firm performance, CG and firm value, CG and corporate accruals, CG and financial disclosure, CG and market capitalisation CG and corporate revenue, the assessment of current practice in light of CG guidelines and so on. In the previous

regression models, board size, ownership structure, board independence, dominant personality, board composition, external auditor, director's compensation are used as independent variables (CG variables) to examine the influence of these variables over dependent variables such as corporate accruals (Hasan, Abdul Rahman & Hossain, 2014; Houqe, Zijl, Dunstan & Karim, 2010), financial disclosure (Hasan, Hossain & Swieringa, 2013a), firm performance (Bonn, 2004a; Chin, Vos & Casey, 2004; Samad, Amir & Ibrahim, 2008), firm value (Klein, Shapiro & Young, 2005; Lefort & Urzúa, 2008), market capitalisation (Hasan & Omar, 2015), corporate revenue (Hasan, Omar & Handley-Schachler, 2015a) and so on.

A short review of previous works is presented to identify the research gap. Bonn (2004) examined the relationship between board structure and performance of large Australian firms. He found a positive association between the ratio of nonexecutive director and firm performance. Samad, Amir and Ibrahim (2008) found a significant relationship between firm performance and board size, independent directors and chairman-chief-executive duality for family and nonfamily ownership while comparing CG and performance between listed companies in family and nonfamily ownership in Malaysia. However, Chin, Vos and Casey (2004) did not find a statistically significant relationship between firm performance and board composition or size or equity ownership structure. On the other hand, Klein, Shapiro and Young (2005) found an association between board structure and performance of family firms while looking at the relationship between firm value and CG practice of Canadian firms. Rashid, De Zoysa and Rodkin (2007) conducted a survey to examine corporate governance practice of Bangladeshi listed companies in light of two dominant models, which are the Anglo-American Model and German-Japanese Model, which requires an additional governance structure, which is a supervisory board with veto power over some decisions. They found the practice of Anglo-American board in Bangladesh. Ahmed, Alam, Jafar and Zaman (2008) reviewed the CG framework, CG model, CG and firm performance as well as CG and firm valuation. The research also examined the relationship between CG and others factors like ownership structure, board members and firm performance from the previous studies. Lefort and Urzúa (2008) provided empirical evidence from Chile, where independent directors and professional directors are included in the board. They found a relationship between the proportion of independent directors and company value. Chen

and Hsu (2009) examined the relationship between family ownership, board independence and Research and Development (R&D) investment. They found a negative relationship between family ownership and R&D investment. They also claimed that family firms may increase R&D investment when board is more independent.

Houqe, Zijl, Dunstan and Karim (2010) examined the relationship between corporate governance and discretionary accruals. They found a significant and positive relationship between good CG and firm quality earnings. However, Hasan, Hossain and Abdul Rahman (2014a) only found a significant relationship between public ownership and corporate accruals. They stated that corporate accruals are not from business cycle, as they do not contribute to company wealth, but they come from the brain of top management in tuning the accounting figures for the sake of appearance. Rashid, De Zoysa and Rudkin (2010) studied the influence of corporate board composition in the form of external independent director proportion on firm economic performance in Bangladesh. They found that the external (independent) directors do not add potential value to the firm economic performance. Karim, Sarkar and Fowzia (2010) examined the compliance of CG practice and CG guidelines. Huq and Bhuiyan (2012) explored problems and weaknesses related to CG practice in the Bangladeshi banking industry. Ferdous (2012) examined the compliance with CG code by developing a corporate governance index (CGI). Koerniadi and Tourani-Rad (2012) studied the effect of independent directors on firm value in New Zealand, using market-based performance measure and accounting-based ratio, and found that independent directors have negative effect on firm value. Fauzi and Locke (2012) studied the role of board structure and the effect of ownership structure on firm performance in New Zealand’s listed firms. They found a significant relationship between board of directors, board committees, managerial ownership and firm performance. Hasan, Hossain and Swieringa (2013a) found a significant relationship between CG and financial disclosure.

Hasan, Abdul Rahman and Hossain (2014) examined the relationship between family ownership and CG structure. They found a deviation in the CG practice of listed companies from the criteria set in the guidelines. They also claimed that good governance is not feasible under a family-based corporate culture. Rashid (2015) examined the relationship between board

independence and firm agency cost for listed firms in Bangladesh. The study did not find a significant relationship between board independence and other attributes such as board and agency cost. It was claimed that the external directors in the board are not truly independent. Bertoni, Meoli and Vismara (2014) analysed a sample of 969 firms that went public in France, Germany and Italy between 1995 and 2011. They found board independence is a critical factor in the valuation of initial public offering (IPO) firms. Hasan and Omar (2015) examined the impact of firm-level CG on market capitalisation, in which there is a significant relationship between board independence and market capitalisation. Hasan, Omar and Handley-Schachler (2015a) found a significant relationship between CG and corporate revenue, demonstrating the CG ability to generate revenue for firm. However, the studies did not examine the importance of board independence separately, leaving a research gap, in which this study attempts to fill the gap by developing an empirical model, where the dependent variable is board independence. The objective of this study is to assess the degree of corporate ownership influence on board independence.

THE VARIABLES AND HYPOTHESES

The variables are selected in line with the study objective. Board independence (BI = y) is selected as dependent variable while family ownership (FO = x1), public ownership (PO = x2) and institutional ownership (IO = x3) are selected as independent variables with the aim to estimate the effect of ownership structure on board independence. Board size (BS = x4), dominant personality (DP = x5), and external auditor (EA = x6) are selected as control variables. The definition and measurement of the variables and the value range are presented in Table 1. A brief review of literature in relation to the dependent and independent variables is presented in Table 1.

Table 1: The Definition, Measurement and Range of Values of Variables

Variables	Definition	Measurement	Range of Values
Dependent Variable			
Board Independence (*BI*)	Board independence is defined as the proportion of independent directors in the board.	Number of independent non-executive directors divided by total number of directors on the board	0 - 1
Independent Variables			
Family ownership (*FO*)	Sponsor shareholders i.e., Family ownership	Code “1” for majority of share held by family members and “0” otherwise.	0, 1
Public Ownership (*PO*)	Public ownership is defined as the ratio of shares held by general people in the ownership structure of sample companies.	Total number of shares held by general people divided by total number of issued shares	0 - 1
Institutional Ownership (*IO*)	Institutional ownership is defined as the ratio of institutional holdings in the ownership structure of sample companies.	Total number of shares held by institutions divided by total number of issued shares or “0” otherwise	0 - 1
Control Variables			
Board Size (*BS*)	Board size is defined as total number of directors in the board of sample companies.	Number of the board of directors.	≤ 20
Dominant Personality (*DP*)	Dominant personality is defined as the position of Chairman and CEO of sample companies are the same person.	Code “1” if Chairman also holds the position of CEO and “0” otherwise	0, 1
External Auditor (*EA*)	External auditor is defined as the reputation of the auditor of sample companies.	Code “1” for internationally linked audit firm and “0” otherwise	0, 1

Board Independence

Board independence is the key factor in the CG system. A lack of board independence indicates low governance and becomes an obstacle to the fulfillment of board legal responsibilities. As a result, the interests of stakeholders including minority shareholders are not strongly protected. Therefore, the importance of external directors is recognised at the public policy level, where corporate governance codes have the need for a reasonable proportion of external directors on the board. Empirical evidence shows that a properly constituted boards with the right mix of nonexecutive directors tend to contribute to performance than board that is dominated by internal directors (Weisbach, 1988; Hermalin & Weisbach, 1991; Bhagat & Black 2001; Mehran, 1995; John & Senbet, 1998; Fosberg, 1989; Yermack, 1996). Board independence is measured by the proportion of external independent directors on the board. According to the provision of corporate governance guidelines, one independent director is required for every four executive directors. The ratio of external directors to internal directors is 1:4, which is 20 percent. The following null hypothesis is formulated for this study, to examine the relationship between board independence and corporate ownership.

> **H_1**: There is no significant relationship between board independence and corporate ownership.

This hypothesis is tested by three alternative hypotheses, to see the effect of three ownership types, namely family ownership, public ownership and institutional ownership, on board independence.

Family Ownership

Family ownership is a big issue in Bangladesh, a country where family members predominate and business environment is virtually unregulated with managerial incentive rather than regulatory influence, in which this situation tend to induce disclosure and influence other reporting issues (Hasan & Omar, 2016). The majority of public company ownership (almost 85 percent) is in the custody of family members (Hasan, Abdul Rahman & Hossain, 2014). The Probe Committee (2011) found that they are responsible for the recent stock market crash. Information asymmetry is one of the

major issues in this situation. The board is supposed to appoint independent directors who work collaboratively with them. Therefore, they spread their control over the board by using their discretionary voting power. They ignore the interest of outsiders and take decision from a family perspective instead of business perspective, which is a major cause of concern. Family-owned companies are less transparent and exercise less voluntary disclosure because of lower demand for information by nonfamily shareholders, as no consensus is required from nonfamily shareholders in business decision (Ali, Chen & Radhakrishnan, 2007). Although Demsetz and Villalonga (2001) highlight a combination of ownership and control to mitigate management expropriation, prior studies prove negative association between family firm and board independence. In Malaysia, Ibrahim and Abdul Samad (2011) found a negative 23.5 percent correlation between independent directors and family ownership, which is quite similar to a negative 36 percent correlation in a study conducted by Mishra, Randoy and Jenssen (2001) on Norwegian firms. Therefore, it is hypothesised that the higher family ownership proportion in the firm affects board independence, leading to the following alternative hypothesis.

> **H_{1a}**: There is a significant association between board independence and family ownership.

Public Ownership

Public ownership is the weakest form of ownership from the aspect of control and the public does not usually have access to the company day-to-day account. They must depend on company annual report for necessary information to evaluate their investment decision. Corporate management is responsible to prepare annual report, whereas board of directors is responsible to approve it and the external auditor is responsible to give opinion regarding its truth and fairness. Management has a unique ability to perpetrate fraud by overstating or understating earnings. They can use discretion to misstate (overstate or understate) the financial information, manipulating the performance. The risk of information asymmetry and misstatement in annual report explains why regulators, policy makers, pressure groups, market operators, professional bodies and researchers are concerned to protect the right of minority shareholders (Hasan, Hossain & Abdul Rahman, 2014a). Accounting manipulation is one of the malpractices used to hike the share

price. Is was found that board of directors and some audit firms fail to perform their duties with sincerity and honesty (Probe Committee Report, 2011) . Without board independence, it is difficult to guard against malpractice such as taking advantage of information asymmetry. Under asymmetric information hypothesis and signalling theory, Xu and Xie (2014) attempted to identify factors affecting the price of entrepreneural firm initial public offering (IPO). Based on 153 listed firms in China's Growth Enterprise Market (GEM), an empirical test for the correlation between IPO pricing and board of director independence was run. They find that the top management ownership is significantly correlated with IPO offering pricing. This means that the top management is acting as internal shareholders in the pricing of entrepreneurial firms than the financially independent boards of directors. Public ownership is when a proportion of company shares are owned by the public. The following alternative hypothesis in relation to board independence and public ownership is therefore tested.

H_{1b}: There is a significant association between board independence and public ownership.

Institutional Ownership

Institutional and corporate structure differ between countries (Koerniadi & Tourani-Rad, 2012). The level of ownership influences the effectiveness of independent directors in monitoring firm performance (Lawrence & Stapledon, 1999). In 2003, Healy (2003) found that institutional ownership in New Zealand was 76 percent, which was much higher than in the US or UK, where institutional ownership was 39.8 percent and 60.8 percent, respectively. The high level of ownership in New Zealand acts as a substitute to compensate weak investor legal protection and underdeveloped capital market (Mikkelson & Partch, 1997; Shleifer & Vishny, 1997). In Bangladesh, the institutional ownership does not play a role in making an independent and effective board (World Bank Report, 2009). It is also argued that high ownership level results in "entrenchment effect" and has negative effect on company performance and valuation (Morck, Shleifer & Vishny, 1988). Institutional ownership is defined as the proportion of company shares owned by financial institution. The following alternative hypothesis is tested to assess the role of financial institution in establishing an independent and effective board.

H_{1c}: There is a significant association between board independence and institutional ownership.

CONCEPTUAL MODEL

Figure 1 shows a diagrammatic visualisation of the model. Board independence is an aspect in corporate governance. Hypothesis H_1 is related to the effect of corporate ownership on board independence. Next, corporate ownership is segregated into three categories, which are family ownership, public ownership and institutional ownership. Then, the influence of each ownership category on board independence is statistically estimated by using multiple regression. Hypotheses 1a (H_{1a}), 1b (H_{1b}) and 1c (H_{1c}) are related to the influence of family ownership, public ownership and institutional ownership on the establishment of a professionally independent board.

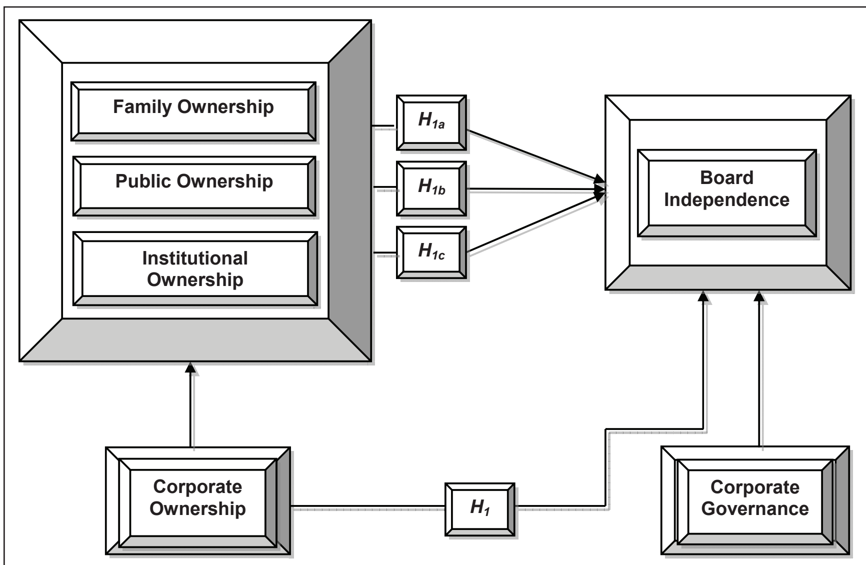

Figure 1: Research Model of Corporate Ownership and Board Independence

RESEARCH APPROACH

Data

Corporate annual reports in 2010 and 2011 were available for 68 out of 155 nonfinancial companies listed on the Dhaka Stock Exchange, the largest stock market in Bangladesh by number of listings. The 68 companies are used as sample for the present research. The CG practice of these companies were compared with CG guidelines. The data for dependent, independent and control variables are extracted from the companies' corporate annual report.

Methods

Descriptive statistics, bivariate analysis, and multiple regression techniques were applied in the analysis. The descriptive statistics are used to show the current situation, the bivariate (correlation matrix) analysis is used to detect the multicollinearity problem between independent variables and multiple regression is conducted to test the three alternative hypotheses.

Because of the prevalence of family ownership in Bangladeshi corporations, the variable for family ownership is a binary variable, in which 1 is the case when majority of ownership belongs by a family and 0 is for the opposite. This is to test whether absolute family control affects board independence. The other ownership variables (public and institutional) have a continuous range, represented by percentage. State ownership of shares is not included in this study, although further research can scrutinise this factor.

A regression model is developed for this study to estimate the degree of influence and to assess the effect of and each type of share ownership (family, public and institutional) on board independence and other possible attitudes. The regression model matrix is presented below. The numbers of rows and columns in the matrix represent the board independence variable of r for company i (the dependent variable is yi) are 68 and 1 respectively. The numbers of rows and columns for the matrix representing the independent variables for company i are 68 and 7 respectively. The numbers of rows and columns for the intercept and coefficients to be established by the regression analysis are 7 (6 coefficients plus the intercept) and 1 respectively. Meanwhile, the numbers of rows and columns for the error term are 68 and 1 respectively.

$$\begin{bmatrix} y_1 \\ y_2 \\ y_3 \\ . \\ . \\ . \\ . \\ y_n \end{bmatrix} = \begin{bmatrix} 1 & x_{1,1} & x_{2,1} & x_{3,1} & x_{4,1} & x_{5,1} & x_{6,1} \\ 1 & x_{1,2} & x_{2,2} & x_{3,2} & x_{4,2} & x_{5,2} & x_{6,2} \\ 1 & x_{1,3} & x_{2,3} & x_{3,3} & x_{4,3} & x_{5,3} & x_{6,3} \\ . & . & . & . & . & . & . \\ . & . & . & . & . & . & . \\ . & . & . & . & . & . & . \\ . & . & . & . & . & . & . \\ 1 & x_{1,n} & x_{2,n} & x_{3,n} & x_{4,n} & x_{5,n} & x_{6,n} \end{bmatrix} \begin{bmatrix} \beta_0 \\ \beta_1 \\ \beta_2 \\ . \\ . \\ . \\ . \\ \beta_p \end{bmatrix} + \begin{bmatrix} \varepsilon_1 \\ \varepsilon_2 \\ \varepsilon_3 \\ . \\ . \\ . \\ . \\ \varepsilon_n \end{bmatrix}$$

Where					
Dependent Variable:			Independent Variables:		
y_i	=	Board independence of company *i*	*Ownership Variables*		
n	=	Number of company observation = 68	x_1	=	Family ownership
		The Error Term:	x_2	=	Public ownership
ε_i			x_3	=	Institutional ownership
Regression Parameters:			*Control Variables:*		
β_0	=	Intercept of the model (constant)	x_4	=	Board size
β_j	=	Coefficient of independent variable *j*	x_5	=	Dominant personality
p	=	Number of independent variables = 6	x_6	=	External auditor

RESULTS AND DISCUSSION

Looking at the results of descriptive statistics, Table 2 shows that the average board independence is at 15 percent, however the value should be at least 20 percent, as stipulated by the provision of CG guidelines[4]. According to this provision, an independent director is required for every four executive board members for board independence. It is also observed that some companies do not even have one independent director despite

4 Section 1.2 sub section i of corporate governance guidelines 2006.

the requirement for a minimum of one independent director and some companies have only one independent director even there are ten board members. Many companies do not maintain the required ratio of independent directors and board size. In Malaysia, if a company has only three board members, two of them are required to be independent[5]. The table also shows that the ownership of 85 percent companies belongs to family members. The users of financial report believe that good governance is not possible under family-based culture (Hasan, Abdullah & Hossain, 2014c). The average proportion of company ownership is 41 percent. It indicates a good individual participation in the capital market but they are not happy with the corporate behaviour. Looking at institutional ownership, the average rate of company institutional ownership is 20 percent. Institutional stakeholders are more knowledgeable and powerful than other stakeholders. They play an important role to implement good governance but in Bangladesh, the role is limited[6].

Table 2: Descriptive Statistics

Variables	N	Minimum	Maximum	Mean	Std. Deviation	CV
BI	68	0	1	0.15	0.14	0.96
FO	68	0	1	0.85	0.36	0.42
PO	68	0.05	0.94	0.41	0.22	0.53
IO	68	0	0.86	0.2	0.21	1.07
BS	68	3	17	7.4	2.29	0.31
DP	68	0	1	0.26	0.44	1.71
EA	68	0	1	0.22	0.42	1.9

From Pearson's product-moment correlation coefficient (Table 3), the results show that there is no multicollinearity problem between the independent variables. This result confirms the nonexistence of linear combination of the variables. Detection of multicollinearity between independent variables is a precondition for multiple regression analysis. If multicollinearity exists between two variables, then one variable needs to be dropped from the model as the two variables measure the same thing. The linear correlation is not considered, indicating multicollinearity exceeds 0.80

5 Listing requirements of Bushra Malaysia Securities Berhad (2006), Busra, Malaysia
6 World Bank. 2009. Report on the observance of standards and codes. Dhaka: World Bank.

or 0.90 (Judge, Griffiths, Hill, Lutkepohl & Lee, 1985; Bryman & Cramer, 1997). Thus, the proposed multiple regression model is conducted without removing any variable from the model.

Table 3: Correlations Matrix

Variables	FO	PO	IO	BS	DP	EA
FO	1					
PO	0.403**	1				
IO	-0.358**	-0.410**	1			
BS	-0.403**	-0.104	0.092	1		
DP	0.249*	0.083	-0.17	-0.061	1	
EA	-0.380**	-0.306*	0.389**	0.219	-0.158	1

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

The results of multiple regression analysis are shown in Table 4. Family ownership has negative influence on board independence at one percent significance level. However, these results reveal no significant influence of other ownership types (institutional ownership and public ownership) on board independence. Therefore, research hypothesis 1a is accepted while hypothesis1b and hypothesis 1c are rejected. The beta value of institutional ownership (IO) and public ownership (PO) are positive (0.019, 0.031 respectively) but not significant, while for family ownership (FO), the beta value is negative and significant (-0.380 at 0.01 level). Consequently, family ownership is considered as an obstruction to board independence. The results also reveal that there is no significant relationship between any control variables and board independence.

Table 4: Results of Regression Test of the Model

Predictors	Coefficients	T - Value	P – Value
FO	-0.38	-3.339	0.001***
PO	0.031	0.248	0.805
IO	0.019	0.154	0.878
BS	-0.147	-1.189	0.239

DP	-0.041	-0.346	0.73
EA	-0.017	-0.137	0.892

Note: **Significant at the 10% level. **Significant at the 5% level. *** Significant at the 1% level.*

The current level of board independence was reviewed by using 8 questions (Table 5) to view a present situation of board independence in companies in general. The results indicate there are insufficient independent directors on board for operational management (Questions 1-3) and some companies have no independent director at all. In addition, some external directors are former executives of the company (Question 4), which may compromise their task in scrutinising the effect of past decision or longstanding policy independently and effectively. Some independent directors also have lack of required expertise to challenge the action of executive directors (Question 5). In some firms, the Chief Executive Officer (CEO) is also the Chairman of the Board (Question 6), which is contrary to recommendation in the CG Guidelines.

The separation of the two roles has two desirable effects: first, it ensures that there are at least two directors, preventing a director from running the company without being scrutinised; second, when the Chairman and CEO are two different persons, the Chairman usually has nonexecutive role, ensuring that there is a powerful nonexecutive figure whom the CEO is answerable to. When a dominant figure occupies both positions, it is easier for that person to take decision which are not in the best interest of the company. For example, the person may act out of self-interest or in the interest of another firm in which the CEO is involved as a shareholder or employee or at the behest of political interest, and sometimes inadvertently, the person acts recklessly, without sufficient knowledge. In other cases, there is a personal, particularly marital relationship between the Chairman and CEO, which leads to weak scrutiny as long as the relationship remain intact. There is a risk of information leak in regards to company affairs in the event of family dispute. As shown in Table 3, family ownership is the most common form of ownership but this is often combined with the existence of nonfamily shareholders minority, whose interest is under threat of misappropriation of income and assets by family members or companies owned by them. The nonfamily shareholders are also vulnerable to information asymmetry in the dealing of shares and voting at shareholders' meetings.

Besides, higher information asymmetry level (Hasan, Abdul Rahman & Hossain, 2014b; Hasan, Abdullah & Hossain, 2014c), lower disclosure level (Hasan & Hossain, 2012; Hasan & Hossain, 2012a; Hasan, 2013; Hasan, Hossain & Swieringa, 2013a; Hasan & Hossain, 2013b), and negative impression by users towards corporate financial reporting (Hasan, 2013; Hasan, Abdullah & Hossain, 2014c) result in board inactivity. Moreover, the overall quality of corporate financial reporting is either poor or not credible at all (Hasan & Omar, 2016). The present governance practice of listed companies is also poor (Hasan, Abdul Rahman & Hossain, 2014).

Table 5: Eight Questions on Board Independence and Corporate Governance

Question No.	Question	Results	Recommended by CG Guidelines	Comment
1	For those companies with independent directors, what is the lowest number of independent directors on the board?	1	2	Minimum number of directors should be two as per Bursa Malaysia, 2006 (Hasan, Abdul Rahman and Hossain, 2014).
2	Is the proportion of independent directors on the board below the recommended proportion in the CG Guidelines, which recommends that companies maintain a ratio of inside directors to outside directors of no more than 4: 1?	Yes	No	During the survey of annual reports, it was observed that some firms have more than five directors but they have only one independent director. The average proportion of independent directors on the board is 15 percent, which is lower than 20 percent as per CG Guidelines.
3	Do all sample companies appoint Independent Directors?	No	Yes	During survey of annual reports, it is observed that some companies have not yet appointed an independent director to the board.
4	Is there any relationship between inside directors and independent directors?	Yes	No	Most of the outside directors are former executives (Rashid, 2011).

Question No.	Question	Results	Recommended by CG Guidelines	Comment
5	Do independent directors have sufficient knowledge and experience which could be used as a guard of protecting managers from information asymmetry?	No	Yes	In some cases it is observed that they do not have sufficient expertise to prevent managers from opportunistic behaviour. Rashid, De Zoysa and Rudkin (2010) find that outside director cannot add potential value to the firm's economic performance in Bangladesh.
6	Is the Chairman ever the same person as the Chief Executive Officer (CEO)?	Yes	No	Some firms still have the same person with a dual position as chairman and CEO) in the name of minimizing the operating expenses although CG Guideline does not allow this duality.
7	Is there ever any personal relationship between Chairman and CEO?	Yes	No	In some cases, it is observed that wife holds Chairman's position and husband hold CEO's position. Again, father holds chairman's position and elder son holds managing director's position.
8	Is family ownership greater than other category?	Yes	Not a Matter for CG Guidelines	It is found that 85 percent of ownership of sampled companies are in the hand of family members or sponsor directors.

The results reveal that of the three categories of corporate ownership, only family ownership has a significant influence on board independence. In other words, the agency problem between shareholders and family ownership is very acute in Bangladesh. The negative attitude (negative beta value) of family ownership towards board independence is a great barrier for firm to practise fairness, accountability, responsibility and

transparency as family members want to gain control of everything. As board is not independent, then it is not feasible for them (board of directors) to discharge their fiduciary duties on behalf of shareholders properly. Besides, it is difficult to achieve separation of ownership and control. On the other hand, the positive attitude (positive beta value) of institutional ownership and public ownership towards board independence indicates that the companies want an independent and effective board for fairness, accountability, responsibility and transparency in governance. If board is not independent, then it is possible for unethical managers to take advantage of information asymmetry and use their position to further their own agenda rather than those of owners, engaging in managerial opportunism (Williamson, 1996). They are in a position to hide or distort information, by keeping these actions hidden or appear as they are for the best interest of shareholders. Shareholders do not realise that there are individuals who have the tendency in advance (Downes & Russ, 2005). The temptation to drive up share price artificially, fabricate profit, and hide loss is too great for those whose job depend on the results (Zandstra, 2002). There is an irony when directors themselves display opportunism, as this defeats their purpose. Therefore, the board, as part of their fiduciary duties to the shareholders, must vigorously seek truth in any situation by being active and proactive, rather than passive and reactive (Downes & Russ, 2005).

Family owners have incentive to expropriate minority shareholders or entrench themselves in managerial position (Shleifer & Vishny, 1997). In general, they prefer to establish board that do not try to alleviate their discretion over decision making (Anderson & Reeb, 2004; Chen & Jaggi, 2000). Board members are dominated by family members or close friends and there are only a few of independent directors (Meng, 2009). The majority of the board members are children and relatives, who act as the executive or nonexecutive directors (Arman, 2010). This reduces the board ability curtail the activities of managers, who are family members or have close relationship with the owners. They may try to manage earnings to meet the interest of family owners at the expense of minority shareholders. From a perception study, good governance is not feasible in a family dominating culture (Hasan, 2013). Hence, board should comprise a majority of "independent" directors who are free from commercial or personal ties, that could impair their ability to probe and challenge management (Felton & Watson, 2002). An independent and effective board can ensure corporate

management accountability, which leads to good governance practice in the firm.

CONCLUSION

The study concludes that board is not independent and among three corporate ownership, only family ownership has a negatively significant influence on board independence. Although institutional ownership and public ownership have no significant influence, but they show a positive correlation with board independence. The study suggests the need to rethink the way to establish an independent and professional board, without majority of shareholders especially family members being a barrier. Otherwise, it is not possible to reduce information asymmetry. The selection of an external, professional director on the board should be conducted through a search committee to ensure their competency and the minimum number of independent directors should be at least two. In light of positive reinforcement theory of motivation, the management should be motivated with this idea in solving the issues. Two-tier board, which exists in Germany, Netherlands and Japan should be considered, as this requires the existence of an oversight board, which consists of no company directors. However, the establishment of an oversight board which is elected by shareholders and middle managers create another avenue company owners (family members) to thwart decision taken by the directors.

An alternative is to use legislation that requires the presence of audit committee and other board committee without the CEO, in which the audit committee wholly consists of nonexecutives to receive report from internal auditors without interference from executives (Committee on the Financial Aspects of Corporate Governance, 1992). The creation of board committee, however, does not guarantee the involvement of independent nonexecutives in strategic decision, where their influence is useful counter to the interest of family members on the board. In addition, independent directors can be selected from available individuals who share similar view or are easily influenced by executives.

It is necessary to establish a board which is not only effective but also independent to discuss company affairs transparently and objectively at the

board meeting. This board can be either a "bloodhound" for opportunities and threats and the "watchdog" for malpractice within the corporation, thus contributing to good strategy and good governance. The study used secondary data and could not consider other board independence aspects such as educational qualification, age and professional experience. A study to cover all aspects of board independence as well as corporate governance is useful to detect the specific weaknesses where corrective measures can be taken to improve the situation.

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