



## **Corporate Governance and Financial Performance Relationship: Case for Oman Companies**

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### **Jel Classification**

G34, O16, L25.

### **Abstract**

The article aims to investigate the relationship between corporate governance and financial performance by using the data of 61 Oman companies traded at Muscat Securities Market for a four-year period from 2013 to 2016. The models are divided into two groups. The first group constructed a corporate governance score which is the dependent variable; the second group used the components of the score separately as dependent variables. As independent variable, two types of indicators are used; market-based and accounting-based. To reflect the market performance, Tobin's q is used and as accounting-based indicators; return on assets, gross profit margin, EBIT margin and net profit margin are used. The results showed that there are significant results between financial ratios and characteristics of corporate governance, but the overall relationship is weak in Oman context. Even though individual effects of some components of corporate governance are not significant, most models produced overall significant results.

## **Introduction**

Corporate governance has become an important topic in developed countries after some events such as frauds and company collapses. In recent years, it has also attracted a great attention in developing countries. Many stock exchanges and regulatory bodies issued directives regarding corporate governance mechanisms and disclosures about them.

The Cadbury report (1992) simply defines corporate governance as 'the system by which companies are directed and controlled'. In a report written for OECD, Iu and Batten (2001) defined corporate governance as follows; "Corporate governance refers to the private and public institutions, including laws, regulations and accepted business practices, which together govern the relationship, in a market economy, between corporate managers and entrepreneurs (corporate insiders) on one hand, and those who invest resources in corporations, on the other". Corporate governance is especially important for publicly held companies with a large shareholders group who are not engaged in the day-to-day operations and have no direct access to inside information. Corporate governance is a framework which specifies the responsibilities and rewards of the parties involved. Although some authors cite different theories as the background of corporate governance, agency theory (Jensen, Meckling 1979) is regarded as the theoretical base of the concept of corporate governance. There is an agency relationship between shareholders (owners) and board of directors, corporate governance refers to the mechanisms designed to resolve the problems arising in this relationship. The term 'governance' is different from 'management' and its root is 'to govern', which means the administration of the State. However, management refers to the day-to-day and long-term decisions in the fields of finance, operations, marketing and so on. Therefore, governance is like bureaucratic administration of the company. Although both of these concepts refer to different aspects of the company, the common point is that they have a great importance on the success or failure of the company. In the literature, there are many studies about the relationship between different fields of management and performance of the company. Similarly, the question of whether corporate governance has any positive or negative effects on the performance of the company has been a concern in the literature.

This paper aimed to investigate the corporate governance-financial performance relationship in Oman context. Oman is the first country which adopted and applied a code

of corporate governance in Gulf region. Oman is a member country of Gulf Cooperation Council which was established in 1981. Similar to other member countries, Oman generates a significant amount of revenue from oil reserves. In recent years, several sectors have started to develop such as tourism, manufacturing, services, and finance. The companies in Oman have some features which make corporate governance more important. Firstly, family businesses have a significant proportion in private sector. Secondly, government has shareholdings in many companies. Due to all these reasons, this study is significant.

Another factor which makes the study significant and original is that it constructed a corporate governance index for Oman companies. With reference to previous studies and rating methodologies, a content analysis was undertaken for corporate governance reports issued by the companies.

The rest of the paper is organized as follows; in the next section, we review the literature especially with a focus on the relationship with financial performance. It is followed by a short overview of the corporate governance environment in Oman. Then, we present the data and methodology. After that, we analyze the results and findings. The last section concludes.

### **Literature Review**

There are many studies about different aspects of corporate governance, in this section we limit the review of literature with only studies focusing on the financial performance relationship. Regarding the relationship, some broad classifications can be made for both financial performance variables and corporate governance variables. The variables used to measure financial performance can be grouped as market-based and accounting-based. The most famous one in market-based group is Tobin's Q, besides some stock market return measures. In the accounting-based group, there are several ratios such as return on assets (ROA), return on equity (ROE), net profit margin (NPM) etc. For corporate governance variables, some studies used and analyzed different characteristics separately such as board size, board independence, ownership concentration etc., while some others calculated an overall measure composed of the similar characteristics. In addition, some studied employed the professional ratings measured by rating institutions.

We can broadly categorize the studies on corporate governance-financial performance relationship into two groups with respect to the measurement of corporate governance characteristics. The first group search for a relationship between a specific dimension or variable of corporate governance and financial performance. For example, board size, the proportion of independent directors, etc. The second group employs an overall corporate governance measure, either developed by the authors or measured by rating institutions.

Boehren and Oedegaard (2003) stated that relating corporate performance to only one dimension of corporate governance may not reveal the true relationship unless that the aspect used is controlled for other aspects of governance. Depending on this argument, many researchers constructed a single governance index, which is a scorecard that measures the corporate governance over a variety of aspects.

Gompers et.al (2003) built a governance index to proxy the balance of power between managers and shareholders by using 24 corporate-governance provisions. The sample used employed the data of 1500 large firms during 1990s. They empirically analyzed the relationship of this index with corporate performance. They concluded that firms with stronger shareholder rights had better results such as higher sales growth, higher profits and higher firm value. In addition, those firms made lower capital expenditures and made fewer acquisitions.

Bebchuk et.al searched for the correlations of 24 provisions used in Gompers' index and offered an entrenchment index based on six provisions. The four of them are "constitutional" provisions that prevent a majority of shareholders from having their way and the two are "takeover readiness" provisions that boards put in place to be ready for a hostile takeover. They found that increases in the level of the index are monotonically associated with economically significant reductions in firm valuation which was measured by Tobin's Q.

Klapper and Love (2004) used firm-level corporate governance ratings from 14 emerging markets and searched for the relationship between firm-level governance and the country's legal system. They also tested whether there is a correlation between corporate governance and operating performance and market valuation of the firm. Their study showed that there is a positive correlation between corporate governance and operating

performance and market valuation. The results also showed that this correlation is higher in countries with weaker legal systems.

Ashbaugh-Skaife et al. (2006) searched for the importance of corporate governance on the firm's risk profile by examining the relationship between corporate governance and credit ratings. They measured corporate governance by using several attributes such as block shareholding, CEO power, accrual quality, etc. They investigated whether there is a relationship between quality of corporate governance and credit ratings and found a negative relationship.

Larcker et al. (2007) developed multi-indicator indices by using principal component analysis in order to mitigate measurement error and to have a comprehensive representation of corporate governance and used these indices to test whether they can explain abnormal accruals, accounting restatements, future operating performance, and future stock returns. According to the results of their study, the indices have a relationship with future operating performance, and excess stock returns. The relationship with abnormal returns is modest and mixed, and there is no relation with accounting restatements.

Bhagat and Bolton (2008) attempted to answer the question of what is the relationship between corporate governance and performance by considering the endogeneity of the relationships among corporate governance, performance, capital structure, and ownership structure. They concluded that better corporate governance is positively correlated with better contemporaneous and subsequent operating performance. Specifically, they found a positive relationship for stock ownership of board members and CEO-Chairman separation, however a negative relationship for board independence.

Lusk et al. (2008) classified companies into three groups based on their corporate governance index scores as autocratic, middle, and democratic. Due to the fact that GIM CGI scores are available for even years, they used also financial performance measures for the years 2000, 2002 and 2004 and analyzed the corporate governance financial performance relationship for the three groups. As financial performance, they used both market measures and accounting-based measures. They found that autocratic form of governance serve better the firm in the markets, but stockholders prefer democratic form.

The relationship of corporate governance and financial performance is affected by several factors. The legal system and financial structure of a country may have significant impacts on this relationship. Anderson and Gupta (2009) performed a cross-country analysis to analyze whether financial structure and legal system matter. They used a sample 1736 firms from 22 countries and concluded that financial structure and legal system of any given country have a joint effect on the relationship. This result is not surprising because stability and confidence in both legal and financial system affect positively performance and governance of companies.

Berthelot et.al (2010) pointed out the attention of capital market participants to corporate governance, particularly their need to identify situations that may cause earnings management and opportunistic behavior. One of the most important information sources about governance practices of firms is rankings published by several institutions. The authors hypothesized that if the market participants use the rankings, there must be a significant positive relationship between the rankings and stock prices. For a three-year period from 2002 to 2005, they used a sample of 796 observations from 289 Canadian firms. They used the rankings published by Canadian newspaper Globe and Mail and found that the rankings have an effect on investors; however the rankings are at least partly reflected in accounting results.

Baxter (2014) investigated the relationship between the corporate governance ratings of Australian publicly listed companies and their financial performance for the years 2006 to 2008. He used the Horwath Corporate Governance Report (HCGR) to measure the variable for corporate governance, which is the mostly known rating in Australia. The companies were allocated a star rating out of a maximum of 5 depending on the extent to which they met the best practice standards and given a ranking relative to the other companies. As the financial performance variables, he used Tobin's Q, ROA and ROE. The results of the study showed that both stars and rankings are positively associated with financial performance.

Ueng (2016) investigated the relationship between the quality of corporate governance policy and the firm financial performance by using a sample of 3068 firms from Corporate Library database. The results of the study showed that firms with a better corporate governance policy are more likely to have a better financial performance.

Some authors searched for the corporate governance-financial performance relationship by considering and focusing on board characteristics such as size and independence. Regarding the board size, which is the number of board members, there are mixed results in the literature. Some studies claimed that larger boards are better, some others claimed the opposite. Empirical findings also produced conflicting results.

Lipton and Lorsch (1992) suggested a proposal covering many aspects for improving corporate governance and they claimed that smaller boards are better than larger boards, even they advised to limit the number of members with a maximum of ten. A smaller board allows members to have more effective discussions. Yermack (1996) analyzed 452 US industrial companies for the period from 1984 to 1991 and found an inverse relationship between board size and firm value which is measured by Tobin's Q. The results also showed that smaller boards are associated with better financial ratios and such companies provide stronger CEO incentives. Coles et al. (2008) examined the effects of board size and board composition on Tobin's Q for the period 1992-2001 and they found that larger boards may be beneficial especially for the cases in which board has important advisory roles, such as the companies which are diversified across industries, large in size and with a high leverage ratio. Some studies found that there is no significant relationship between board size and financial performance. Kumar and Singh (2013) found insignificant results between board size and Tobin's Q in their study covering 2008-2009 period and 176 publicly-held companies from Indian Stock Exchange. ALJifri and Moustafa (2007) investigated the impact of internal and external governance mechanisms on financial performance in United Arab Emirates (UAE). Even though they found significant results for some mechanisms such as government ownership, the impact of board size was found to be insignificant. Arouri et.al conducted a study in banking sector of GCC countries to measure the impact of corporate governance mechanisms on performance. They found that board size had no significant impact on the performance of banks.

Zakaria et.al examined the relationship of board governance and firm performance for a sample of 73 trading and services sector listed at Malaysian stock exchange for the period of 2005-2010. They found that a positive association between board size and firm performance by controlling for investment opportunities, firm age, leverage and firm size.

Regarding board independence and foreign board members, they found insignificant results.

The proportion of independent directors, also known as board independence, is another important characteristic of corporate governance. The empirical studies which searched for the relationship between board independence and financial performance produced mixed results. (Yermack, 1996, Weir and Laing 2001, Bhagat and Black, 2002; Perry and Shivdasani, 2005, Pham, P.K. et al, 2011, Shan and McIver, 2011).

Another indicator used to evaluate the corporate governance of a firm in both ratings and empirical studies is the number of board meetings. It is argued that as the number of meetings increases, it improves the decision-making efficiency of the board and then it positively affects firm performance. Although this line of reasoning seems logical and acceptable, some studies found opposing results. (Vafeas, 1999; Brown and Caylor, 2006.)

Institutional ownership is also one of the aspects affecting corporate governance. It is argued that as the proportion of institutional shareholding in the ownership structure, the financial performance of the company is affected positively. Similar to other aspects, empirical findings about the institutional ownership are mixed.

Block ownership is one of the indicators which may affect corporate governance and it is also known as ownership concentration, meaning that how the shareholdings of the company are distributed and how many blockholders are there. Laeven and Levine (2008) examined the relationship between ownership structures and valuations in Europe. They found that the market value of the companies with multiple blockholders is significantly different from those with a single blockholder and from widely held companies. Blockholders are mostly institutional investors, however there is a distinction between institutional ownership and block ownership. Block ownership refers to the biggest shareholder regardless of that it is individual or institutional. The results of empirical studies searching for the effect of block ownership on financial performance produced mixed results. (Ben- Amar and Andre, 2006; Laeven and Levine, 2008; Pham, P.K. et al, 2011; Kang and Kim, 2012)

Bozec and Dia (2014) investigated the governance-performance relationship for Canadian companies over the period 2002-2005, with respect to shareholders' proximity which is defined based on ownership concentration and whether or not the dominant/controlling



shareholder holds top executive positions in the firm. They found a positive relationship between governance indices and Tobin's Q. They also showed that ownership concentration and holding key positions by controlling shareholder do not have any impact on the relationship.

There are two positions at companies which are important both for corporate governance and management of the operations; chairman of the board and CEO. In some companies, they are separate, in some others the same person holds both positions. This aspect of governance is known as CEO Duality and it is widely searched in empirical studies. There are two opposite arguments for CEO Duality; the first one claims that when these positions are held by different persons, it will affect positively the decision making and therefore financial performance. On the other hand, the second one claims that when the positions are held by the same person, it will decrease bureaucratic procedures and produce better results. The empirical studies also produced conflicting results. (Brickley et.al, 1997; Coles and Hesterly,2000; Bhagat, S. and Bolton, B.,2002; Elsayed, K.,2007; Chahine and Tohmé, 2009; Cheng.2013; Duru et.al, 2016)

### **Corporate Governance In Oman**

Among Gulf countries, Oman is the first to adopt corporate governance for publicly held companies. The process of modernization for Oman dates back to 1970s. His Majesty Sultan Qaboos bin Said initiated the process after he assumed power in 1970. Regarding the companies and corporate governance, the first step was the promulgation of the Commercial Companies Law which sets the legal mechanisms of all types businesses. The next milestone was the establishment of the Muscat Securities Market which opens the era of 'public' companies. Similar to all other countries, the need for the mechanisms to solve problems of public companies such as internal control and transparency issues, conflicts of interest among shareholders and management and so on. In 2002, the Capital Market Authority issued corporate governance standards for publicly held companies, known as Corporate Governance Code (CGC). The CGC was updated in 2010 and 2015. The New Code which become effective as of 22 July 2016 included 14 principles and the explanations regarding the corporate governance mechanisms and clarified many issues such as board

composition and its roles, the concepts of “independence” and “related party” and provisions about the committees.

The CGC applies to all public joint stock companies listed on the Muscat Securities Market and accordingly it is compulsory to publish a Corporate Governance Report together with yearly financial statements and independent audit report. In addition to CGC report, some companies disclose more detail about their corporate governance mechanisms in the annual reports.

Code of Corporate Governance in Oman has 14 principles which are summarized below:

*First Principle - Purpose of Corporate Governance:* It presents the purpose of CG as setting out the processes by which firms are directed enabling them to contribute national economy, stakeholders and local community. It determines main pillars of CG as transparency, accountability, fairness and responsibility.

*Second Principle- Board of Directors' Formation, Roles and Responsibilities:* It states that all firms must be directed by a Board of Directors which leads and controls operations, and is responsible for long term success. This principle also clarifies the requirements, duties and rights of the members of BoD.

*Third Principle - Board of Directors' Authority and Competences:* This principle requires the articles of association approved by general assembly to set out authority and competences of BoD and it must be accessible to the public.

*Fourth Principle -Chairperson:* It specifies the profile, role and responsibilities of the chairperson, emphasizing his/her role in the implementation of corporate governance.

*Fifth Principle - Company Secretary:* It requires BoD to appoint a secretary to assist the board in complying to CGC and other applicable legislation.

*Sixth Principle - Executive Management:* It emphasizes the role of executives in implementation of strategic plans and procedures.

*Seventh Principle - Professional conduct of Directors and Executives:* It states the importance of professional conduct and ethics for executives in performing the duties.

*Eighth Principle - Independent Director:* It states that BoD members must have complete independence from management and major shareholders. Independence covers two dimensions; financial and opinion. It also specifies the cases in which independence is violated.

*Ninth Principle - Rules for Related Party Transactions:* It emphasizes the necessity of transparency and clarity regarding the related party transactions and requires the review of the transactions by audit committee and approval by BoD or general assembly.

*Tenth Principle - Audit Committee and Internal Controls:* It emphasizes the role and importance of audit committee and internal control systems and states that BoD ensure the existence and functioning of them to safeguard the interests of shareholders.

*Eleventh Principle - Nomination and Remuneration Committee:* It states the importance of nomination and remuneration policies and requires a balance of the remuneration to attract competent directors and the rights of shareholders.

*Twelfth Principle - External Auditors:* This principle states that the BoD is responsible for accurate presentation of financial statements through external auditors and therefore specifies the requirements for appointing the external auditors.

*Thirteenth Principle - Corporate Social Responsibility:* This principle requires the integration of corporate social responsibility into firm's activities and to exercise the roles as a good citizen and prevent adverse impacts on stakeholders.

*Fourteenth Principle - Annual Reports:* This principle states the role of the annual reports published by the firm with respect to the implementation of corporate governance and requires annual reports to indicate the practices are in line with principles and standards of corporate governance.

## **Data and Methodology**

### ***Sample***

The sample used in this study includes 61 industrial and service companies traded at Muscat Securities Market for a four-year period from 2013 to 2016. It is a balanced panel with 244 observations.

### ***Models and Variables***

Panel data regressions were run to search for the relationship between corporate governance and financial performance. Two groups of models were developed depending on the independent variable. In the first group, the independent variable is corporate governance which is measured by using a scoring index. We constructed the scoring index by using the parameters used in previous studies and methodologies of rating institutions.

The construction of the index is explained in the next section. In the second group, the components of the corporate governance score are included separately as independent variables. In both groups, the dependent variable is the financial performance which is measured by one market-based indicator, Tobin's Q, and four accounting-based measures, namely EBIT, Net Profit Margin (NPM), Return on Assets (ROA) and Return on Equity (ROE). Therefore, ten models were run in total.

We used three control variables for size, gearing and growth. Size is measured as the natural logarithm of total assets. Gearing is measured as the ratio of total liabilities to total assets. Growth is measured as the percentage change in sales in each year compared to the previous year.

We constructed the following models by using all the variables mentioned above. Each model uses one of the financial performance indicators as the dependent variable and overall corporate governance score as the independent variable.

Model 1: Tobin's Q  $_{it} = \alpha_0 + \text{CG Score}_{it} + \text{CV} + \varepsilon_{it}$

Model 2: EBIT Margin  $_{it} = \alpha_0 + \text{CG Score}_{it} + \text{CV} + \varepsilon_{it}$

Model 3: Net Profit Margin  $_{it} = \alpha_0 + \text{CG Score}_{it} + \text{CV} + \varepsilon_{it}$

Model 4: Return on Assets  $_{it} = \alpha_0 + \text{CG Score}_{it} + \text{CV} + \varepsilon_{it}$

Model 5: Return on Equity  $_{it} = \alpha_0 + \text{CG Score}_{it} + \text{CV} + \varepsilon_{it}$

In the second group of models, the components of CG score were used as independent variables.

Model 6: Tobin's Q  $_{it} = \alpha_0 + \text{BS}_{it} + \text{BIND}_{it} + \text{NOMT}_{it} + \text{INSO}_{it} + \text{BLCO}_{it} + \text{CV} + \varepsilon_{it}$

Model 7: EBIT Margin  $_{it} = \alpha_0 + \text{BS}_{it} + \text{BIND}_{it} + \text{NOMT}_{it} + \text{INSO}_{it} + \text{BLCO}_{it} + \text{CV} + \varepsilon_{it}$

Model 8: Net Profit Margin  $_{it} = \alpha_0 + \text{BS}_{it} + \text{BIND}_{it} + \text{NOMT}_{it} + \text{INSO}_{it} + \text{BLCO}_{it} + \text{CV} + \varepsilon_{it}$

Model 9: Return on Assets  $_{it} = \alpha_0 + \text{BS}_{it} + \text{BIND}_{it} + \text{NOMT}_{it} + \text{INSO}_{it} + \text{BLCO}_{it} + \text{CV} + \varepsilon_{it}$

Model 10: Return on Equity  $_{it} = \alpha_0 + \text{BS}_{it} + \text{BIND}_{it} + \text{NOMT}_{it} + \text{INSO}_{it} + \text{BLCO}_{it} + \text{CV} + \varepsilon_{it}$

where BS: Board Size, BIND: Board Independence, NOMT: Number of meetings, INSO: Institutional Ownership, BLCO: Block Ownership, CV: control variables.

## **Methodology**

We run panel (longitudinal) data regressions to test the significance levels of the models constructed in the study. Panel data is defined as a data set consisted of repeated cross sections over time. With a balanced panel, the same units are observed in each time period. With an unbalanced panel, some units do not appear in each time period, often due to attrition. (Wooldridge, J.M, 2002). We have data for all variables during the study period, there is no missing value, then it is a balanced panel data.

We used Stata software to run the data analyses. For each of the models, panel regression with fixed effects and panel regression with random effects were run. Depending on the results, a comparison made among the regressions to determine which model must be chosen. Hausman test is performed in order to decide between fixed and random effects. The model chosen at this step must be tested for heteroscedasticity. In the regression models, there is an assumption that the variance of the error term is constant and it is defined as homoscedasticity. If the error terms do not have constant variance, they are called as heteroscedastic. Errors may increase as the value of an independent variable increases. Breusch-Pagan / Cook-Weisberg (estat hottest) test is designed to detect any linear form of heteroscedasticity.

## **Corporate Governance (CG) Index**

This study constructed a corporate governance index by using the previous studies in the field and methodologies of rating institutions. The data for the index are collected through the content analysis of corporate governance reports published by the companies. It is compulsory to publish a corporate governance report according to the requirements of the Capital Market Authority. The reports are audited by independent audit firms. The items included in the index are board size, board independence, number of board meetings, institutional ownership, and block ownership (ownership concentration). The index covers 5 items, all of which is scored out of 10, which makes a total score of 50. Therefore maximum score is 50. We constructed CG score by giving points out of 10 to the five characteristics of the companies. The rationale underlying the scoring for each item is explained in the following paragraphs and summarized in Table 1.

Although there are opposing studies in the literature about ideal number of board members, in other words, whether smaller boards or larger boards are better, we assumed that larger boards are more effective and helps make better managerial decisions and results in better financial performance. Accordingly, we attached a higher score to the companies with a larger board. Board independence is measured as a percentage of independent members to the total number of members. We assumed that a higher percentage of board independence is better, so we attached a higher score to the companies with higher board independence level. Number of board meetings is scored by the assumption that meeting more frequently helps increase the coordination among members and make more effective decisions, so we attached a higher score to the companies with a higher number of board meetings. For institutional ownership, we used ascending scoring method; as the percentage of shares held by institutional investors increases, the score also increases. We assumed that this characteristic is positively related to financial performance. So, for each increment of 10 %, we attached 1 point, for example if the institutional ownership is between 51% and 60 %, the company receives 6 points. For ownership concentration, we used the percentage of shares held by the largest shareholder. As this percentage increases, we attached a higher score with the increments of 10 %. Another characteristic of corporate governance used in scoring in previous studies is CEO duality. We did not include it in our scoring, because all companies in the sample has CEO duality, which means CEO and Chairman of the Board positions are represented by different people. Therefore, this feature of corporate governance is not also included in second group of models as an independent variable.

After calculating the scores, we converted them into percentages. For example, if the score is 20, it is divided by the maximum score, that means  $20/50 = 0.40 = 40\%$ .

## **Analysis of The Results**

### ***Descriptive Statistics***

Descriptive statistics for all the variables used in the study are presented in Table 2, categorized as financial, corporate governance and control variables. It shows mean values and standard deviations, minimum, maximum values which are reported as overall,

between, and within for panel data. The standard deviations of financial variables are not high except TQ whose standard deviation is 0.64, with a maximum of 3.15 and a minimum of 0.07. For CG Score, maximum is 78 % and minimum is 27 %, and overall standard deviation is 0.11. Average score for the sample is 55%. This score shows that adoption and implementation of corporate governance mechanisms are not at expected levels. Board sizes range from 5 to 12, with an average of 7.36. Board Independence is 1 at maximum, which means that all board members are independent directors; and 0 at minimum, which means there is no independent director at the board. Almost half of the companies in the sample have BoD composed of all independent directors. Number of Meetings is 15 at maximum and 4 at minimum, with an average of 5.86. Institutional Ownership ranges from 99% to 0 %, with an average of 56 %. Similarly, block ownership which shows the ownership percentage of the largest shareholder ranges from 99% to 9 %, with an average of 40%.

Table 1: Definitions of Corporate Governance Items

Item	Definition	Expected Relationship	Scoring Scale
Board size	Number of members at BoD	The larger BS, the higher the score	from 1 to 10
Board Independence	The proportion of independent directors at BoD	The higher the BI, the higher the score	from 1 to 10
No of meetings	Number of BoD meetings in a year	The higher the no of meetings, the higher the score	from 1 to 10
Institutional ownership	The percentage of ownership by institutional investors	The higher the percentage, the higher the score	from 1 to 10
Block ownership	The percentage of ownership by the largest shareholder	The higher the percentage, the higher the score	from 1 to 10

Table 2: Descriptive Statistics for the Variables

		TQ	EBITM	NPM	ROA	ROE	CGS	BS	BI	NM	IO	BO	SZ	GE	SG
Mean		0.89	0.11	0.09	0.06	0.09	0.55	7.36	0.70	5.86	0.56	0.40	3.37	0.43	0.23
Std. Dev.	overall	0.64	0.20	0.19	0.08	0.23	0.11	1.51	0.28	1.90	0.26	0.22	1.38	0.24	2.76
	between	0.60	0.18	0.16	0.07	0.22	0.11	1.49	0.26	1.56	0.26	0.22	1.38	0.23	1.41
	within	0.22	0.09	0.10	0.04	0.08	0.03	0.30	0.11	1.10	0.03	0.02	0.13	0.06	2.38
Min	overall	0.07	-0.89	-0.90	-0.27	-1.66	0.27	5.00	0.00	4.00	0.00	0.09	0.78	0.09	-0.75
	between	0.09	-0.68	-0.70	-0.18	-1.20	0.28	5.00	0.22	4.00	0.00	0.11	0.88	0.10	-0.15
	within	-0.14	-0.34	-0.63	-0.12	-0.37	0.41	4.36	-0.06	2.87	0.40	0.32	2.67	0.15	-10.66
Max	overall	3.15	0.93	0.63	0.38	0.58	0.78	12.00	1.00	15.00	0.99	0.99	6.73	1.37	43.00
	between	2.44	0.51	0.45	0.25	0.40	0.76	12.00	1.00	12.00	0.99	0.99	6.69	1.28	11.02
	within	1.80	0.77	0.70	0.23	0.51	0.63	8.36	1.02	10.87	0.76	0.54	3.91	0.60	32.21



**The Results of the Models**

The results of the models are summarized in the following tables. Table 3a shows the panel regression results for the models in which overall corporate governance score (CG Score) is independent variable and financial performance indicators are dependent variable. With respect to overall significance of the model, all models found significant results, except model 5 in which ROE is dependent variable. With respect to the relationship of CG score on financial performance indicators, only ROA has a significant relationship, but it is negative. Other financial variables do not have any significant relationship with CG score. This result can be interpreted in the way that corporate governance mechanisms do not contribute to financial performance. The previous studies also produced conflicting results. All models in Table 3a, Size and Sales Growth have significant effects. Gearing is significant for only model 3 and 4, in which net profit margin and return on assets are dependent variables respectively.

Table 3a: Panel Regression Results for the Models 1-5

	<b>Model 1</b>	<b>Model 2</b>	<b>Model 3</b>	<b>Model 4</b>	<b>Model 5</b>
Dependent Variable	Tobin's Q	EBIT Margin	NPM	ROA	ROE
Constant	3.643*** (0.725)	0.119 (0.0923)	0.196** (0.0847)	0.146*** (0.0394)	0.108 (0.112)
CG Score	-0.275 (0.5578)	-0.196 (0.171)	-0.224 (0.1805)	-0.118** (0.058)	-0.193 (0.217)
Size	-0.774*** (0.226)	0.0363** (0.0127)	0.0305*** (0.0107)	0.0124** (0.0061)	0.0504* (0.0289)
Gearing	0-.0022 (0.318)	-0.0454 (0.088)	-0.212*** (0.066)	-0.136*** (0.0252)	-0.1801 (0.133)
Sales growth	-0.0031*** (0.0006)	-0.0046*** (0.0009)	-0.0002 (0.0009)	-0.00014 (0.0004)	-0.0001 (0.0009)
R <sup>2</sup>	0.23	0.096	0.14	0.26	0.19
F-Test	12.68***	-	-	-	
Wald Chi <sup>2</sup>	-	45.32***	28.61***	31.09***	3.53
Observations	244	244	244	244	244

\*, \*\*, \*\*\* represent significance levels for 10%, 5%, and 1%, respectively. Robust standard errors are shown in parentheses. Depending on the model adopted, F-test or Wald Ch<sup>2</sup> is reported.

Table 3b summarizes the results of the models in which components of corporate governance score are included as independent variables and the same financial indicators as dependent variable in each model. Similar to first group of models, these models also produced significant results with respect to overall significance except model 10 in which ROE is dependent variable. Board Size is found to be insignificant in all models. It can be interpreted that number of members in the BoD has no relationship with financial performance of the firm. In the literature, there are similar studies with the same result. (e.g, ALjifri and Moustafa (2007), Arouri et.al (2011), Kumar and Singh (2013)). Board independence is significant in only model 8 in which net profit margin is dependent variable. The coefficient is negative, meaning that there is an inverse relationship between financial performance and board independence. Number of meetings is significant for only model 9 in which ROA is dependent variable. Although it is very weak, there is a negative relationship between number of meetings and financial performance. Institutional Ownership produced significant results for three models in which EBIT margin, net profit margin and ROA are dependent variables. The directions of the relationships are positive, which means institutional ownership affects financial performance positively. Block ownership showed significant results for three models in which EBIT margin, net profit margin and ROE are dependent variables. The directions of the relationships are negative, which means there is an inverse relationship between block ownership and those financial indicators. Size produced significant results for all models, which means firm size is an important variable in corporate governance-financial performance relationship. Gearing produced significant results only for two models in which net profit margin and ROA is dependent variable respectively. Similarly, Sales growth showed significant results only for two models in which Tobin's Q and EBIT margin are dependent variables, respectively.

Table 3b: Panel Regression Results for the Models 6-10

	<b>Model 6</b>	<b>Model 7</b>	<b>Model 8</b>	<b>Model 9</b>	<b>Model 10</b>
Dependent Variable	Tobin's Q	EBIT Margin	NPM	ROA	ROE
Constant	3.51*** (0.597)	0.173 (0.1333)	0.279** (0.139)	0.1424*** (0.0455)	0.0963 (0.0951)
Board Size	0.0404 (0.0512)	-0.0198 (0.0182)	-0.0266 (0.0204)	-0.0031 (0.0049)	0.0073 (0.0126)
Board Independence	-0.024 (0.148)	-0.0588 (0.0577)	-0.0556* (0.0329)	-0.0112 (0.0183)	0.0646 (0.0797)
Number of Meetings	-0.0178 (0.0132)	0.0003 (0.006)	-0.0063 (0.0066)	-0.0038* (0.003)	-0.0050 (0.0038)
Institutional Ownership	-0.497 (0.535)	0.2148*** (0.077)	0.2588*** (0.0693)	0.0579* (0.0324)	0.0017 (0.0728)
Block Ownership	0.3340 (0.7935)	-0.3297** (0.1304)	-0.3255** (0.1324)	-0.1214 (0.0483)	-0.3596** (0.1744)
Size	-0.7881*** (0.1433)	0.0426*** (0.0118)	0.0423*** (0.0116)	0.0135** (0.0055)	0.0421* (0.0225)
Gearing	-0.0111 (0.278)	-0.0099 (0.097)	-0.1778** (0.0906)	-0.1295*** (0.0261)	-0.1608 (0.111)
Sales growth	-0.003*** (0.006)	-0.0048*** (0.0010)	-0.0005 (0.001)	-0.00021 (0.0004)	-0.0003 (0.0009)
R <sup>2</sup>	0.25	0.28	0.34	0.32	0.33
F-Test	12.79***	-	-		
Wald Chi <sup>2</sup>	-	47.53***	38.69***	47.16***	9.11
Observations	244	244	244	244	244

\*, \*\*, \*\*\* represent significance levels for 10%, 5%, and 1%, respectively. Robust standard errors are shown in parentheses. Depending on the model adopted, F-test or Wald Ch<sup>2</sup> is reported.

## **Conclusion**

In this study, we aimed to search for the relationship between corporate governance and financial performance of Oman companies at Muscat Securities Market. We constructed two groups of models. In the first group, we used a corporate governance index score as the independent variable to measure the level of corporate governance. In the second group, we used the components of the corporate governance index as separate independent variables. In both groups, we used one market-based indicator of financial performance, which is Tobin's Q, and four accounting-based indicators of financial performance, EBIT margin, net profit margin, ROA and ROE.

In the first group, all models produced significant results except ROE (model 5), according to overall significance value of the model. However, only ROA (model 4) found a significant result for Corporate Governance score. Similarly, in the second group, all models produced significant results except ROE (model 9), according to overall significance value of the model. When looked at the details for components of corporate governance, we found different results for each model. The model 6 showed that none of the components have a significant effect on Tobin's Q. The model 7 showed that Institutional Ownership has a positive relationship with EBIT margin, while Block Ownership has a negative relationship with the same indicator. The model 8 aimed to find the relationship between the components and net profit margin (NPM), it showed that there is a negative relationship between Board Independence and NPM, and a negative relationship between Block Ownership and NPM. It also showed that there is a positive relationship between Institutional Ownership and NPM. The model 9 showed that there is a weak negative relationship between Number of Meetings and Return on Assets (ROA) and also that there is a positive relationship between Institutional Ownership and ROA.

These results show that the relationships between financial performance indicators and corporate governance, as overall score and separate components, are weak in Oman. One potential reason might be the poor adoption and application of corporate governance regulations. Although the Code of Corporate Governance is applicable for all public companies and they publish the standard format report, the results raised the question of whether the companies internalized the principles of corporate governance and whether

they have effective governance mechanisms, rather than reporting the minimum requirements.

This study relied on the content analysis of corporate governance reports. Those reports have some advantages. One of the advantages is that the reports are audited by independent auditors, and secondly there is a standard content determined by CMA. This makes it easier to calculate the scores.

There are some future research areas. The study covered non-financial companies, a similar study can be conducted for financial sector companies in Oman. In addition, a multi-country study can be conducted covering, for instance, GCC countries by using a more-detailed scoring index.

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