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The impact of board independence on accounting-based performance

Evidence from Saudi Arabia and Bahrain

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Abstract

Purpose – The purpose of this paper is to explore the effect of board independence on firm's performance from the Stewardship theory perspective.

Design/methodology/approach – The study uses panel data of 162 firms listed in Bahrain Bourse and Saudi Stock Exchange during the period of 2013-2015. It also uses several econometric techniques to confirm the robustness of the results, such as firm fixed-effect approach and two-stage least squares (2SLS) in order to overcome the endogeneity which exists in such relations.

Findings – The study found an inverse effect of board independence on firm performance which was measured using two accounting-based measures: return of assets and return on equity. Based on these results, it was found that internal directors are more effective in enhancing performance of the firm than independent directors as information asymmetry problem and lack of firm-specific experience hinders the ability of independent directors of taking proper decisions that enhance firm's performance.

Originality/value – The study contributes to the ongoing debate about the relation between board independence and firm's performance in emerging markets, focusing on Saudi and Bahraini markets which have recently sought to form a system of laws that aims at protecting investors. The study indicates the importance of such laws rather than traditional governance measurements in enhancing performance.

Keywords Board independence, Stewardship theory, Accounting-based performance

Paper type Research paper