

CORPORATE GOVERNANCE AND PERFORMANCE OF THE FINANCIAL FIRMS IN BAHRAIN

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Abstract: The aim of this paper is to explore the relationship between corporate governance and performance of the financial firms in the Kingdom of Bahrain. The study uses annual data of all listed financial firms on the Bahrain Bourse over the period of 2011-2016. The results show that board size, ownership concentration and auditor's reputation have a positive and significant impact on firms' return on assets (ROA), whereas the percentage of independent directors and the annual number of board meetings have negative and significant impact on firms' return on equity (ROE). CEO duality is found to not be an important determinant factor of firms' performance, as the results suggest that it shows insignificant effect on ROA, ROE and stock returns (SPR). Furthermore, firm's size and leverage are found to have negative and insignificant relationship with firms' performance.

Key words: corporate governance, firm performance, emerging market, Bahrain

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Introduction

How should an organization be structured and managed is a long standing debate in literature. Under the organizational economics paradigm, there are some theories attempting to explain some part of this classical question. Transactional cost theory (Williamson, 1981 among others), Agency Theory (Jensen and Meckling, 1976 among others), Price Theory (Friedman, 1962 among others) and Property Right Theory (Coase, 1937 among others) are examples of this kind. These theories have addressed 'the contractual nature of firms, bounded rationality, the significance of investment in specific assets, the distinction between specific rights and residual rights and the effects of imperfect information' (Shafritz et al., 2011). Shafritz et al., (2011:243) underlined the fact that these theories share a common answer to explain how an organization is existed and expanded by a term of hierarchy, which is built upon costs associated with uncertainties, information asymmetries, bounded rationality and cognitive barriers. More importantly, these theories try to explain how to make an agent (manager) to act in the best interest of principle (owner).

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At the management of firm point of view, board of directors and executives act as an agent of the shareholders who supposed to maximize shareholders' wealth maximization. Due to several factors, conflict of interest arises between agent and principle which is known as agency problem. In order to eliminate these problems, some actions are taken place such as monitoring and auditing mechanism. Agency cost, which is defined as the cost incurred as a result of agency problem plays an important role in terms of corporate governance.

Corporate governance can be considered as a set of principles that lead the firm management to be transparent to the shareholders in particular and stakeholders in general (Jensen and Meckling, 1976). Regulating the authority among stakeholders is ultimate outcome of these principles (Kusuma and Ayumardani, 2016). It is claimed that best practices of these principles ensure the firm to be efficient, effective, economical and productive (Jenkinson and Mayer, 1992). With the implementation of these principles at the local market, companies show better performance (Pietrasieński, 2014). More specifically, managerial characteristics of the firm such as board structure, ownership structure, level of diversification and debt level may have influence on firm performance (Alias et al., 2017).

Corporate governance is viewed as the means to organize and control firms. This aims to drive the company based on sound governance principles professionally. In an ordinary corporate arrangement, implementation of corporate governance is mandated to be done by the board of directors. The shareholders are given the responsibility to appoint the board and sometimes auditors (Naimah and Hamidah, 2017). The role of the auditors is usually to provide an assessment of the firm's financial statements on a regular basis or when called upon. Mechanisms of corporate governance include performance-based salaries of managers or CEOs, stock ownership by executive officers and directors, the board of directors' characteristics and age and tenure of CEOs. The board of directors is usually mandated to defend the interest of investors in a company on their behalf. Measures of characteristics of the board of directors include the percentage of independent directors/outside directors, the size of the board and CEO duality.

Good corporate governance principles involve responsibility, fairness, accountability and transparency (Aras and Crowther, 2008a; Pauceanu, 2016). Such type of governance in a firm is contributed by many players including shareholders, employees, creditors and the government. As reported by Aras and Crowther (2008b), good corporate governance has been reported to contribute to better firm performance. This is because it is usually implanted to optimize the returns for the investors in a company. The purpose of this research is to find if good corporate governance contributes to the better performance of the financial firms in Bahrain. This is aimed at agreeing or refuting what previous scholars set up as evidence for performance improvement of the firms due to strong corporate governance elsewhere.

Corporate governance is an important aspect while studying firm performance because it is as equally significant as the company's business plan. It shapes

the shared philosophy in the corporation, which enhances the culture and cooperation within the organization (Salim et al., 2016; Hilkevics and Hilkevica, 2017; Jurkevičius and Bublienė, 2017; Sulphey and Alkahtani, 2017; Grenčíková et al., 2017).

When executed effectively, it can prevent corporate scandals, fraud, civil and criminal liability of the company. If this shared philosophy breaks down, service delivery will be poor, products will be defective and management will grow complacent and corrupt. The result is a fall that will occur in the form of questionable audited financial reports leading to criminal investigations, which risks company's bankruptcy (Kliestikova, et al., 2017; Kliestik, et al., 2018). Furthermore, dishonest and unethical dealings within the company can cause shareholders to flee out of fear, distrust and disgust. In Bahrain, little has been done to establish whether corporate governance culture enhances the company's performance regarding return on assets and stock returns. This research is written to bridge the research gap, which exists in the form of the relationship between corporate governance and firms' performance in Bahrain since the enactment of the corporate governance code in 2011.

Particularly, increasing global corporate competition has been a challenge for the growing business market in Bahrain to attract and retain investment. Thus, in order to enhance, develop and promote vibrant capital market in Bahrain, it is important to increase the awareness in addition to the implementation of good corporate governance practices. Recently, the government of Bahrain opted to enhance investor's confidence and economic development through the provision of good corporate governance principles. In 2011, the Kingdom of Bahrain issued its own corporate governance code in cooperation between the Ministry of Industry, Commerce & Tourism, Central Bank of Bahrain and the national corporate governance committee (MoICT, 2010).

The objective of the present paper is to test whether good corporate governance has an impact on the performance of the financial firms listed on Bahrain Bourse. As highlighted in the literature review, several studies have found some form of relationship between corporate governance and firm performance. However, none of them has empirically done in Bahrain, especially following the new corporate governance code. Thus, which factors of corporate governance have an impact on firms' performance especially in Bahrain is yet to be established. Despite the increasing evidence of the failure of particular governance structures to motivate management to increase company's performance, the nature of an optimal governance structure is still not clear with empirical evidence giving mixed results. The main purpose of this research is to test if corporate governance contributes to the better performance of the financial firms in Bahrain. Thus, the objective of this study is to assess whether a significant relationship exists between corporate governance factors (board size, the percentage of independent directors, CEO duality, ownership concentration, auditor's reputation, the annual number of board meetings, firm's size and leverage) and firm performance.

This paper is organized as follow, Section 2 reviews the literature, Section 3 presents the research methodology, Section 4 discusses main empirical results and Section 5 concludes the paper.

Literature Review

Board Size

Board size is a major factor in firm management and ultimate performance; it is a determinant of monitoring and control of the managers by the directors in a company (Naimah and Hamidah, 2017). Researchers have differed on the direction of influence of board size on the performance of the firm. For instance, while gathering information from Spencer Stuart executive search and consulting firm on 69 commercial banks from six OECD countries, Andres and Vallelado (2008) found evidence that board size has an inverted U-shaped relation with banks' performance. The study used a two-step system estimator to overcome the well-known endogeneity problem in the previous literature on corporate governance. The results also indicated that bank's board size related to the ability of directors to monitor and advise executive management, the possibility of maintaining more efficiency in monitoring and advising roles, as well as creating more value through large and less independent boards. Adams and Mehran (2012) conducted a study to examine the relationship between corporate governance, in particular, the board size and the performance of randomly selected 32 publicly traded Bank Holding Companies (BHCs) in the U.S. for the period 1986-1999. The results showed that the size of the board of directors has a positive relationship with the performance of the companies. They also argued that increasing the size of the board of directors by adding more directors with subsidiary directorships might increase the value as organizational complexities increase due to mergers and acquisitions. The study further suggested that unique features of bank governance should be taken into consideration for better governance regulation.

On the contrary, Zabri et al. (2016) tested whether board size had any impact on the performance, which was measured by ROA and ROE. Data was collected from top 100 publicly listed companies in Bursa Malaysia. The results indicated that board size was insignificant suggesting no influence on the ROE, and it had a weak negative relationship with the ROA. Similarly, Bin and Yi's (2015) paper was based on a sample of 16 government-linked companies listed on Bursa Malaysia for the period of 2007 to 2012. Their results showed insignificant relationship between the board size and firm performance. In another research, Guo and Kumara (2012) investigated the relationship between board size and firm performance in research conducted on firms listed on the Colombo Stock Exchange (CSE) whereby data for this study was collected from 174 companies in the year 2010 and processed by multiple regression analysis. Their findings showed that board size had a marginal negative relationship with the profitability of the firms.

Percentage of Independent Directors

Directors in a company are usually expected to be independent of the management and serve as trustees to the investors of the firm. As such, they ought to be fully aware of the firm's relevant issues and question where necessary with a lot of freedom. Previous research on the impact of independent directors on the performance of firms gave mixed results with a vast majority however, reporting a positive relationship. To find out the impact of independence of directors on the performance of the firm, Liang et al. (2013) studied the impact of board characteristics in terms of percentage of independent directors on bank asset quality with a sample of 50 large Chinese banks for the years 2003-2010. The results showed that the proportion of independent directors had a significant positive impact on bank asset quality. They, however, cautioned that the degree of board members political connection had a negative relationship with bank performance and asset quality. Similarly, Liu et al. (2015) investigated the relationship between the independence of the boards of directors and firm performance for Chinese firms listed on the Shanghai and Shenzhen Stock Exchanges during 1999 to 2012. They found that independent directors had a positive relationship with the performance of Chinese firms. The results also confirmed that government-controlled firms had a stronger positive correlation between board independence and performance.

However, Brown and Caylor (2006) computed governance scores for 2,327 individual firms registered in the Institutional Shareholder Services (ISS) as of February 1, 2003. They reported a negative relationship between the independence of directors and ROE, profit margin, dividend yield and stock repurchases. They realized that firms would be better off if they were monitored by executive directors who engaged in actual management activities. This is also confirmed by Salim et al. (2016) who found an insignificant relationship between the independency of the board's directors and the performance of the Australian banks, which supports the stewardship theory. With a different angle, Mersland and Strom (2009) conducted a study to examine the effects of corporate governance on the performance of microfinance institutions. The data included a sample size of 278 microfinance institutions from 60 different countries for the years 2000 to 2007. They found that financial performance improved in firms with local directors instead of foreign directors in the board.

CEO Duality

According to Kouki and Guizani (2015), a powerful manager who tends to dominate the boards of directors is referred to as the dual CEO. Sometimes they may still be chairs of the board. Such CEOs may weaken the power of the board sometimes at the expense of the shareholders. They may maximize their interest in a firm since they enjoy the discretion to "rubber stamp" the decisions of the board. Similarly, Bhagat and Bolton (2008) confirmed that the separation of CEO and chairman of the board positions had a positive association with

the performance of the firms. They used risk metrics databases with director information for 1,500 large U.S. companies from 1990 to 2007. In another research drawn by Mollah and Zaman (2015), they evaluated the relationship between CEO duality and banks' performance; they particularly focused on the differences between conventional and Islamic Banks (IBs). The sample size of the study included 172 banks (86 Islamic banks and 86 conventional banks) during the period 2005–2011 from 25 different countries. They found that dual CEOs negatively influenced the performance of the Islamic banks. Additionally, Judge et al. (2003) also conducted a survey on a small sample size of Russian firms. The results showed that CEO duality was negatively related to the performance of the firms, which was in line with the previous literature.

Ownership Concentration

Omran et al. (2008) defined major shareholders as shareholders who own more than 10% stake in a firm, whereas in Bahrain, major shareholders were defined as shareholders who own 5% and above in a firm; according to the corporate governance code that was enacted in 2011 (MoICT, 2010). While investigating the effect of ownership concentration on firm performance of all Italian listed firms between 2006 and 2009, Alimehmeti and Paletta (2012) conducted an extensive literature review and concluded that managers working in firms with large shareholders were less likely to divert from the shareholder's views. For instance, they were less likely to invest in diversification to unrelated venture against the wishes of the shareholders. Large shareholders tend to have a strong influence on decisions made by the managers/CEOs. They further insisted that larger shareholders might have stronger incentives to monitor and therefore, they should oblige managers to be aligned with their objective of increasing the value of their shares. Using panel data for Romanian firms listed on the Bucharest Stock Exchange (BSE), Vintila et al. (2014) noted that the presence of few majority shareholders reduces the liquidity of the firm's stock in the market, which seems unlikely to contribute to further monitoring of the firm by the shareholder. They argued that presence of many medium-sized shareholders could form coalitions and exercise joint control over the firm's management team. Another interesting observation was that an additional increase in the concentration of the top five shareholders by 10% led to a 2% increase in short-term profitability.

On the contrary, Abdallah and Ismail (2016) studied the relationship between ownership concentration and the performance for all of the firms listed on the stock exchanges in the Gulf Cooperating Council (GCC) countries from 2008 to 2012. They indicated that dispersion of ownership due to numerous small shareholders could lead to free-riding, less monitoring on management thus leading to poor performance of the firm, as CEOs will not worry about pleasing the many shareholders. Additionally, Omran et al. (2008) concluded that firms controlled by a small number of shareholders were managed and run by their wishes. They further argued that such ownership concentration had no significant effect

on firm performance. Their results were based on the analysis of 304 firms from different sectors and from 4 different countries (Egypt, Jordan, Oman and Tunisia). There are cases, when country use buy back contracts, what causes getting back to ownership concentration (Ardalan et al., 2017), and opposite cases, ownership diluted by workers' buyout (Monni et al., 2017).

Auditors Reputation

Auditors play an important role of scrutinizing the company's accounts to ensure that relevant and credible information is reported about the position of the firm (Naimah and Hamidah, 2017). Thus, auditors are a form of protection for shareholders against fraud or misrepresentation of the firm's position and performance. A well-reputed auditor may force management to work in the best interests of the shareholders and manage the firm well to show good performance. Studies, which have analysed the link between the use of reputable auditors and firms performance, suggest a positive relationship. To find out the influence of reputable auditors on firm performance, Kim et al. (2013) performed their analysis on Korean manufacturing firms. The study was based on stakeholder's perspective on the reputation of the auditor. The study used multiple regression analysis to examine the collected data for the period of 2005-2007. The results showed a statistically significant relationship between audit institutions and shareholder's wealth generated by those companies. Similarly, Zagorchev and Gao (2015) performed their analysis on U.S. financial institutions for the years 2002-2009. Their findings stated that engagement of reputable auditors was positively associated with excessive risk taking by shareholders and also positively related to firm performance. Another study drawn by Wahab et al. (2007) on a sample of 440 Malaysian firms for the period 1999 to 2002 supported the results from the previous literature. They found that reputable auditors are more likely to eliminate financial errors and instill transparency in the firms' financial documents since they have a reputation to protect.

Board Meetings

Frequent board meetings could indicate the ability of the board to offer regular and frequent monitoring and advisory roles to the managers in the firms. As suggested by Masulis et al. (2012), the higher the number of board meetings, the greater the scrutiny the management will be under, and decisions that require board approvals will be taken on a timely basis. Salim et al. (2016) studied the relationship between the annual number of board meetings and the efficiency of Australian banks for the period of 1999 and 2013 by conducting Data Envelop Analysis (DEA). The study found that firms with more frequent committee meetings performed better than their counterparts. Andreou et al. (2014) assessed the relationship between corporate governance and firm performance in the maritime companies with board meetings as one of the independent variables. The results indicated that the number of board meetings was strongly correlated with financial management decisions

and firm performance. The study suggests that findings might be helpful to mitigate agency problems and improve management decision in maritime companies. In another study, Chauhan et al. (2016) investigated the effects of board meetings on firm performance for listed Indian firms. The study showed that board meetings were positively related to firm performance. The results also indicated that the relationship became stronger for firms with more frequent board and committee meetings.

Firm Size

Firm size has been widely argued to be related to the economies of scale of operations of firms. Larger companies are expected to enjoy economies of large-scale operations, which reduce the cost of operations and increase the profitability (Pervan and Višić, 2012). For instance, they examined the relationship between firm size and firm performance on a sample of Croatian firms during the period 2002-2010. The results showed that firm size has a significant positive, however weak impact on firm profitability. They argued that larger firms could easily get a lower interest rate and bigger discount rates while purchasing firm inputs. Cahaya and Riwayati (2016) used ROE and ROA to measure firm performance. The authors used linear regression analysis, and according to their results, firm size was significantly and negatively related to firm performance measured by ROE, but positively and significantly related to ROA. Lee (2009) also has conducted research on the role of firm size on the profitability of the companies. The author used fixed data model to analyse 7000 US publicly held companies. The results showed that company size plays a significant role in explaining profitability. However, marginal gains in profitability reduced for larger companies since the relationship was nonlinear. Another study drawn by Amato and Burson (2007) tested the relationship between firm size and profit for firms operating in the financial services sector. The authors examined both linear and cubic form of the relationship. In the linear specification in firm size, it was revealed that a negative influence of firm size on its profitability existed. However, this influence wasn't statistically significant. But the cubic relationship between ROA and firm size was positive and significant. Similarly, Papadognas (2007) conducted analysis on a sample of 3035 Greek manufacturing firms for the period 1995-1999. After dividing firms into four size classes, regression analysis was applied, which revealed that for all size classes, firms' profitability is positively influenced by firm size. In contrast to the previous studies, Amato and Wilder (1985) tested size-profitability relationship in a linear as well as quadratic form on a sample of US manufacturing firms. However, the results of their analysis showed that there is no connection between firm size and profit rate.

Leverage

Several researchers have pointed out that financial leverage can positively influence firms profitability (Margaritis and Psillaki, 2010; Demirguc-Kunt and

Huizinga 2009; Tamulevičienė, 2016). To understand this phenomenon, Mangalam and Govindasamy (2010) analysed the impact of financial leverage on the profitability of the firms using earnings per share as the proxy for profitability. Seven firms listed on the Bombay Stock Exchange (BSE) were involved in this analysis for seven years. Using ANOVA as the method of analysis, they established a positive relationship between the financial leverage of the firms and earnings per share of the firms. They, however, cautioned that the leverage effect was positive when the earnings of the firms were higher than the fixed charges to be paid to the lenders. Thus, financial leverage is an important factor with a greater impact on the profitability of the firms and the eventual wealth of the shareholder. Therefore firms should be able to secure debts prudently to maximize the shareholders gain.

Data and Methodology

This research covers 15 financial firms comprising 13 banks and 2 insurance companies listed on Bahrain Bourse for the period 2011-2016. Data was manually collected mainly from secondary sources from the firm's annual reports for the related period. Important factors related to corporate governance were the main targets in the reports to allow an analysis of the objective of this research. The independent variables include board size, the percentage of independent directors, CEO duality, ownership concentration, auditor's reputation and the number of board meetings. Whereas the dependent variables include return on assets (ROA), return on equity (ROE) and stock returns (SPR). It is important to note that firm's leverage and size are included as a control variable in the model as suggested by (Naimah and Hamidah, 2017).

The dependent variables are well-known profitability indicators.

ROA: Stands for return on assets which is calculated as $\text{Net Income} / \text{Total Assets}$. This represents the return generated by the use of the firm's assets. It is shown as a percentage. ROA has been used in several studies as an indicator to express the profitability of the firms contributed by the firm's assets. Such studies include; Zabri et al., (2016); Yoo and Jung, (2015); Cahaya and Riwayati (2016) and Amato and Burson (2007).

ROE: Stands for return on equity and it is calculated as $\text{Net Income} / \text{Total Equity}$. It represents the return generated on the shareholder's investment into the firm. Widely used by investors, the ROE ratio is an important measure of a company's earnings performance. The ROE tells common shareholders how effectively their money is being employed. While highly regarded as a profitability indicator, the ROE metric does have a recognized weakness. Investors need to be aware that a disproportionate amount of debt in a company's capital structure would translate into a smaller equity base. Thus, a small amount of net income (the numerator) could still produce a high ROE off a modest equity base (the denominator). This is especially important for financial institutions such as banks that are by nature highly leveraged. This ratio is used to measure firms' performance in many studies

such as Abdallah and Ismail (2016); Brown and Caylor (2004); Aebi et al. (2012); Ramli and Ramli (2016) among others.

SPR: Is calculated as the change in stock price in year one (P_1) over the price in the base year (P_0). It should be noted that this measure is different from the total stock returns, which require the addition of dividends to the equation. As the purpose of this study is to measure the performance of the firms, the dividend policy is not taken into account. This is a useful indicator to assess the investors' viewpoint of the firm i.e. does corporate governance affect the investors' perception of the firm in the sense that better corporate governance increases the demand for the stock. Many scholars have used this profitability indicator in their studies as a dependent variable such as Adams and Mehran, (2012); Wahab et al. (2007) and Gupta and Sharma (2014).

Data Analysis

Before running the regression, independent variables were tested for multicollinearity using Variance Inflation Factor (VIF). A pairwise correlation analysis was also performed to determine the level of correlation between all variables used in the analysis of the objective. Finally, multiple linear regression analysis was done for the hypotheses of this study to test the relationship between corporate governance variables and ROA, ROE and SPR.

Table 1. Summary of Variables

Variable	Specification	Expected Sign
ROA	Net Income / Total Assets	%
ROE	Net Income / Total Equity	%
SPR	Change in share price in year 1 over the price in the base year	%
Board Size	Number of directors in the board	+/-
Percentage of Independent Directors	Percentage of directors with no material relationship with the firm	+/-
CEO Duality	Whether the CEO and the Board Chairman are the same individuals	-
Ownership Concentration	How much of a firm stake do the major shareholders own	+/-
Auditor's Reputation	1 if the auditor is one of the big four firms and 0 if it is any other	+
Number of Board Meetings	Total number of annual board meetings	+
Leverage	The amount of total liabilities/total assets	+
Firm Size	Natural log of the total assets	+

Descriptive results for the variables used in the empirical analysis are reported in Table 2.

Table 2. Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max
Return on Assets (ROA) %	0.41	3.05	-19	5
Return on Equity (ROE) %	3.51	12.53	-52	18
Stock Returns (SPR) %	0.52	37.17	-50	162
Board Size	9.39	2.07	5	13
Percentage of Independent Directors %	44.76	19.95	11	100
CEO Duality	0.01	0.12	0	1
Ownership Concentration %	64.43	25.30	0	96
Auditor's Reputation %	0.91	0.29	0	1
Number of Board Meetings	5.67	1.70	0	10
Leverage %	74.02	20.37	16.39	92.73
Firm Size	13.21	2.31	7.78	16.36

The results for ROA indicate that on average, ROA is 0.41% for the firms involved in the analysis. The mean return on equity is impressively 3.51% while the stock return is 0.52%. Regarding the size of the boards of financial firms in the industry, the mean board size is 9 members with the largest board size having 13 members. Further, the percentage of independent directors is relatively high at 45%, while dual CEOs are very low at 0.01%. Interestingly, the results reveal that major shareholders own about 64% of stake in the firms included in the analysis. This is fascinating, as many firms are majorly owned by investors who had 5% and above of the firm's stocks. The results further reveal that most firms engaged reputable auditors in scrutinizing their financial reports. Nearly all firms, 91% to be precise engaged reputable auditors. The mean number of board meetings held in firms per year is 6 with the largest number of board meetings held being 10. Finally, for the control variables, the results indicate that firms are highly leveraged with the mean financial leverage being 74%. This may be due to the fact that the sample size of this research included mostly banks, which are highly leveraged by nature. The results further reveal that the average firm size is 13 (natural log of total asset).

Pairwise Correlation Analysis

The results in Table 3 show that there is a significant correlation between ROA and ROE, which is to be expected as these are indicators of profitability, but both ROA and ROE are insignificantly correlated to SPR. From the correlation analysis, it is evident that most independent variables are not very significantly correlated with the dependent variables. Board size is significantly correlated with ROE. This would suggest that bigger boards result in higher returns to the shareholders. It could be that the larger boards have many members who provide a variety of expert advice to the CEOs of the firms. Board size is also significantly correlated with firm's financial leverage and size. This is expected, as larger financial institutions have larger board size and are highly leveraged. Most financing agents assess the firm's performance before crediting them with their money. Perhaps larger board size provides an impetus for funding these firms in this case.

Table 3. Pairwise Correlation between Variables

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
(2)	0.78***									
(3)	0.09	0.07								
(4)	0.18	0.53***	0.04							
(5)	-0.22*	-0.26**	0.09	0.06						
(6)	-0.02	-0.03	0.05	-0.13	-0.01					
(7)	0.29**	0.14	-0.11	-0.11	-0.35***	-0.17				
(8)	0.21*	0.22*	0.20*	0.26**	0.33***	0.04	-0.0474			
(9)	-0.08	0.12	-0.03	0.26**	0.06	0.09	-0.10	0.42***		
(10)	0.21*	0.28**	0.17	0.54***	0.23**	-0.0131	0.10	0.75***	0.40***	
(11)	-0.01	0.06	0.09	0.37***	0.17	-0.03	0.06	0.34***	0.09	0.50***

Note: ***, **, * indicate significance at 1%, 5% and 10% levels, respectively. (1) ROA; (2) ROE; (3) SPR; (4) Board Size; (5) % Independent Directors; (6) CEO Duality; (7) Ownership Concentration; (8) Auditor's Reputation; (9) # of Board Meetings; (10) Leverage; (11) Firm Size

Another key observation is that financial leverage and auditor's reputation are significantly correlated. Again auditor's reputation is an important signal for financing. Firms that employ reputable auditors build their credibility to the public and financing agents. This may explain why firms, which have engaged reputable auditors, are highly leveraged.

Financial leverage and firm size are also significantly correlated. This implies that bigger firms are highly leveraged. This is expected, as debt financing is required for the growth of firms. It could also be that large firms which engage reputable auditors have greater access to debt financing hence, higher leverage. Additionally, financial leverage is significantly correlated with ROA and ROE. This indicates that financial institutions in Bahrain have been able to use leverage to increase returns on both their assets and to the shareholders' equity.

CEO duality and firm size are insignificantly correlated to all of the dependent variables. Most financial institutions in Bahrain do not have a dual CEO due to the Bahrain Corporate Governance Code (MoICT, 2010); as a result, this variable does not show a strong correlation with any dependent variable.

Surprisingly, the percentage of independent director is significant but negatively correlated to both ROA and ROE, which suggest that higher rates of independent directors may hinder the firms to operate efficiently.

On the other hand, ownership concentration is significantly related to ROA, but negatively and insignificantly related to SPR. This means that, although firms with high ownership concentration are more profitable in accounting terms, the investors are not so keen about the stock's prices. It could also mean that firms with very high ownership concentrations such as family owned business and closely held companies have little floating shares available for the market to trade leading to fewer and smaller size of trade, which does not affect the share price much.

Another interesting relationship is between ownership concentration and percentage of independent directors. The results show that these two variables have

significant and negative relationship. This is against the expectations; as shareholders who own bigger proportions in the firm would be expected to appoint a board member that represents them thus increasing the number of board members. In Bahrain, the law allows anybody with a 10% stake in a firm to appoint a director to represent him/her (MoICT, 2010). If a shareholder owns a bigger percentage, then for every 10% owned in the firm, one board member may be appointed. For example, a shareholder owning 40% in the firm may appoint 4 directors in the board to represent him/her, or even sometimes they could be directors themselves.

Before running the regression analyses, the data was tested for statistical problems of multicollinearity. Multicollinearity is state of very high inter-correlations or inter-associations among the independent variables.

It was tested using variance inflation factor method (VIF) for all the variables and results presented in Table 4.

Table 4. Variance Inflation Factors

Variable	VIF	1/VIF
Financial Leverage	4.01	0.2496
Auditor's Reputation	2.85	0.3505
Board Size	1.75	0.5715
Firm Size	1.41	0.7107
Ownership Concentration	1.4	0.7150
Percentage of Independent Directors	1.35	0.7383
Number of Board Meetings	1.33	0.7530
CEO Duality	1.09	0.9150
Mean VIF	1.9	

The results confirm that there is no serious linear relationship among the explanatory variables since VIF values were less than 10. VIF values of more than 10 would indicate the presence of serious multicollinearity that would require an intervention to address it. Therefore, since there was no serious multicollinearity, all the variables were used in the multiple regression analysis.

Empirical Results

To analyse the relationship between corporate governance and firms' performance, multiple regression analysis results are presented in Table 5. The models of ROA and ROE fits the data reasonably well as the F-test that all regression coefficients are jointly equal to zero is rejected. This is indicated by $P > F$ of 0.0034 and 0.0066 for ROA and ROE respectively. The results then show that the estimated coefficients are significantly different from zero. However, F-test for SPR suggests that the regression coefficients are jointly equal to zero.

The coefficients of determination show that around 19.64% of the variations in ROA, 17.6% variation in ROE, and 2.76% of variations in SPR are explained by the independent variables in the regression model. In general, there is a weak

relationship between corporate governance and firm performance as revealed by these low adjusted R-square numbers. Looking at the independent variables, it is revealed that board size, the percentage of independent directors, ownership concentration, auditor's reputation in addition to the number of board meetings are significant in explaining the variations in profitability of the firms. However, CEO duality, leverage and firm size are found to be insignificant.

Table 5. Results for Multiple Regressions

Variable	ROA		ROE		SPR	
	Coefficient	SE	Coefficients	SE	Coefficients	SE
Board Size	0.4161**	0.20	2.0048**	0.84	-1.1256	2.80
Percentage of Independent Directors	-0.0352*	0.02	-0.2107***	0.08	-0.0776	0.25
CEO Duality	1.8110	2.87	1.3508	11.97	7.9906	39.66
Ownership Concentration	0.0315**	0.01	0.0344	0.06	-0.2333	0.20
Auditor's Reputation	4.4540**	1.83	12.6424	7.62	20.4020	25.26
Number of Board Meetings	-0.4898**	0.21	-0.4724	0.89	-3.8612	2.96
Leverage	-0.0050	0.03	0.0189	0.13	0.3433	0.43
Firm Size	-0.2439	0.16	-0.6349	0.67	-0.1239	2.24
Constant	-1.6425	2.63	-9.9133	10.95	-1.1256	2.80
Prob> F	0.0034		0.0066		0.6458	
Adjusted R^2	0.1964		0.1760		0.0276	

***, **, * indicate significance at 1%, 5% and 10% levels, respectively

The results in Table 5 also show that having a bigger board significantly increased the performance of the firms in terms of improved ROA and ROE. This means that for financial firms in Bahrain, having larger board would increase firms' performance. This could be because larger boards will have members who are experts in different fields that bring their expertise and experience to the table. Moreover, any decisions that have been approved by the board would have to be acceptable to the majority members, which can protect the firm from detrimental decisions. The result is consistent with the study by Andres and Vallelado (2008), who have suggested that board size has an inverted U-shaped relation with bank performance (i.e. increasing the board members to a certain level will be beneficial to the firm). Similarly, Adams and Mehran (2012) have reported that board size has a positive relationship with the performance of the firms, whereas many other studies have reported a negative correlation between board size and firm performance (Bin and Yi, 2015; Guo and Kumara, 2012; Zabri et al., 2016).

Unlike board size, the percentage of independent directors shows an unexpected negative and significant association with both ROA and ROE. This means that a higher number of independent directors have a negative impact on the performance of financial firms in Bahrain. Although independent directors are supposed to perform the monitoring and supervisory function of the board,

especially ensuring that minority shareholders' interests are also represented in the board, they may be a hindrance in the profit making process. Generally, independent directors are at a disadvantage in terms of available information and expertise of the company as compared to executive directors. Moreover, it can be argued that independent directors are appointed to protect shareholder interest not to improve performance i.e. their role is limited to ensuring proper controls, disclosures and management of the firm while executive directors are responsible for risk taking decisions. This result is similar to that obtained by Salim et al. (2016) and Brown and Caylor (2004). However, several other studies such as Dedu and Chitan (2013), Liang et al. (2013), and Liu et al. (2015) have shown a positive relationship between independent directors and firm performance. The main argument is that independent directors tend to give opinions freely without being swayed by inside directors or the CEOs.

Regarding ownership concentration, the regression results show that there is a positive and significant relationship between ownership concentration and ROA. Ownership concentration can conceptually improve firm performance due to increased monitoring. On the other hand, such owners can create benefits at the expense of other shareholders, or repress managerial initiatives due to the excessive control. This result is in line with Alimehmeti and Paletta (2012) who argued that larger shareholders usually have stronger incentives to monitor the firm and oblige managers to be aligned with their objective of increasing the value of their shares. However, other studies have found an insignificant or even negative relationship between ownership concentration and firms' performance (Abdallah and Ismail, 2016; Vintila et al., 2014; Omran et al., 2008).

Auditor's reputation also has a positive and significant relationship with ROA. External audit constitutes one of the governance mechanisms that allow for disciplining managers and hence reduces agency costs including the misrepresentation of financial results. Thus, properly audited financial reports help to lessen the likelihood of fraud in the firms and build the investor confidence, which then propels the company forwards. This result is consistent to those obtained by Zagorchev and Gao (2015), Kim et al. (2013) and Wahab et al. (2007) who argue that credible auditors have built their credibility and reputation for doing good auditing. This then serves as a signal for investors to invest their money in firms with better audit quality.

According to our expectations, CEO duality is not an important factor in the determination of firms' financial performance. One reason for this could be that the Bahrain corporate governance code and the regulations of Central Bank of Bahrain do not permit such arrangement. CEO duality is considered a negative element of corporate governance. The result is similar to the findings of several scholars (Kouki and Guizani, 2015; Mollah and Zaman, 2015; Bhagat and Bolton, 2008; Judge et al., 2003)

The annual number of board meetings unexpectedly shows that there is a negative and significant relationship with ROA. It could mean that the board meetings

in these firms are destructive rather than constructive. Again, board meetings are supposed to be the primary monitoring tool of the board. The lower number of board meetings would suggest that management is put under less scrutiny to explain their actions and it would also mean that management has greater autonomy in decision-making. This result contradicts findings of the studies done by (Salim et al., 2016; Chauhan et al., 2016; Andreou et al., 2014; Wahab et al., 2007) who have found a positive relationship between board meetings and firm profitability. Finally, control variables, firm's leverage and size are also not significant factors in the determination of ROA, ROE and SPR.

Conclusion

Several studies have shown some form of linkage between corporate governance and firms' performance; whether corporate governance causes the improvement in firm performance or high performing firms choose to adopt good corporate governance principles is a subject of debate. However, not all studies have arrived at the same results; in fact, some have concluded to the contrary. This research has attempted to analyse this relationship among financial institutions in Bahrain. The study is conducted to find the relationship between corporate governance and firm's performance. In order to measure firm's performance three profitability indicators are included in the analysis. These are ROA, ROE and SPR in multiple regression analysis. From the results, although there is a weak relationship as indicated by the low adjusted R-square, it can be concluded that board size, ownership concentration and auditor' reputation positively and significantly influence ROA of firms in Bahrain. On the contrary, the percentage of independent directors and number of board meetings negatively and significantly influence ROA. Among these variables, only board size and percentage of independent directors has a significant relationship with ROE. Notably, percentage of independent directors negatively influences ROE. Finally, CEO duality, firm's size and leverage do not have a significant effect on ROA, ROE and SPR of firms in Bahrain.

To put it briefly, firms with a greater number of board members, with highly concentrated ownership, audited by one of the big four auditing firms, with fewer number of independent directors and less board meetings in a year tend to perform better than their counterparts. Some of these findings may seem contrary to popular corporate governance notions and efforts of regulatory authorities such as the central banks.

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ŁAD KORPORACYJNY A WYNIKI FIRM FINANSOWYCH W BAHRAIN

Streszczenie: Celem artykułu jest zbadanie związku między ładem korporacyjnym a wynikami firm finansowych w Królestwie Bahrajnu. W badaniu wykorzystano roczne dane wszystkich notowanych firm finansowych w Bahrajnie w okresie 2011-2016. Wyniki pokazują, że wielkość zarządu, koncentracja własności i reputacja audytora mają pozytywny i znaczący wpływ na rentowność aktywów przedsiębiorstw (ROA), podczas gdy odsetek niezależnych dyrektorów i roczna liczba posiedzeń zarządu mają negatywny i znaczący wpływ na przedsiębiorstwa z kapitałem własnym (ROE). Dualizm dyrektorów generalnych nie jest istotnym czynnikiem determinującym wydajność firm, ponieważ wyniki sugerują, że ma on niewielki wpływ na ROA, ROE i stopy zwrotu (SPR). Ponadto stwierdzono, że wielkość firmy i jej wpływ mają negatywny i nieistotny związek z jej wydajnością.

Słowa kluczowe: ład korporacyjny, wydajność firmy, rozwijający się rynek, Bahrain

巴林金融公司的公司治理和绩效

摘要: 本文旨在探讨巴林王国公司治理与金融公司绩效之间的关系。该研究使用2011-2016.

年期间巴林证券交易所上市所有上市金融公司的年度数据。研究表明，董事会规模，股权集中度和审计师声誉对企业的资产收益率（ROA）具有积极和显著的影，而独立董事比例和董事会年度会议数量对企业回报率有显著负向影响股本（ROE）。发现CEO二元性不是影响公司业绩的重要决定因素，因为结果表明它对ROA，ROE和股票收益（SPR）没有显著影响。此外，公司的规模和杠杆被发现与公司的业绩有负面和微不足道的关系。

关键词: 公司治理，公司业绩，新兴市场，巴林