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## Optimizing Board Composition: An Empirical Analysis of Size, Director's Independence and Non-Executive Directors' Impact on Firm Performance in Oman

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### ABSTRACT

This paper explores the multifaceted relationship between board composition and firm performance in the Sultanate of Oman, with a focus on board size, board independence, and the role of Non-Executive Directors (NEDs). Drawing on data from non-financial firms listed on the Muscat Securities Market (MSM) over a decade (2012-2022), the study employs Ordinary Least Squares (OLS) multivariate regression analysis to dissect the influence of these governance variables on a suite of financial performance metrics. The results indicate that larger board sizes are positively associated with firm liquidity, market valuation, and resilience to corporate failure, as evidenced by significant relationships with the current ratio, Tobin's Q, and Altman's Z score. In contrast, smaller boards are linked to higher profitability margins. The study also finds that the presence of NEDs has a positive and significant impact on firm performance, particularly in terms of liquidity, firm value, and risk management, challenging the traditional view that board independence is a primary driver of firm success. By contributing to the theoretical discourse on corporate governance, this research offers practical insights for corporate managers, investors, and policymakers in Oman and similar economies. It suggests that an optimal board composition is contingent upon the specific performance objectives of a firm and underscores the importance of strategic board structuring in enhancing firm performance. The study provides a foundation for future research in the field of corporate governance, emphasizing the nuanced roles of board size, independence, and NEDs in shaping firm outcomes.

### INTRODUCTION

The composition of a company's board of directors plays a pivotal role in shaping its corporate governance and, by extension, its organizational outcomes. In the Sultanate of Oman, the corporate governance landscape is marked by distinctive regulatory and economic conditions that underscore the importance of board structure. This article extends its examination beyond board size to include the impact of board independence and the presence of non-executive directors on firm performance within the Muscat Securities Market (MSM).

Analyzing data from 2012 to 2022, coinciding with review and the enforcement of Oman's corporate governance code, this study provides a comprehensive view of how these board characteristics influence firm performance over time. The enforcement period offers a unique lens through which to observe the interplay between board structure and firm outcomes, particularly in light of the regulatory emphasis on board independence and the strategic role of non-executive directors.

By concentrating on non-financial firms listed on the MSM, the research illuminates the optimal board composition that bolsters firm profitability, liquidity, and market valuation. It delves into the nuances of board size, scrutinizing whether smaller or larger boards correlate with better performance metrics. Furthermore, it assesses the contribution of independent directors to enhancing oversight and accountability, as well as the value that

non-executive directors add through their expertise and external networks.

The findings of this study are poised to offer valuable insights for stakeholders, including corporate managers, investors, and policymakers. By contributing to the discourse on corporate governance in Oman, this research aims to inform best practices that optimize board structures for the advancement of firm performance in the region.

### Problem Statement

Corporate governance landscape is increasingly complex, particularly in developing economies such as Oman, where the interplay between board composition and firm performance is under heightened scrutiny. Corporate governance failures have led to firm-level crises and exacerbated broader economic challenges, as highlighted by Oman and Blume (2005). The global financial crisis of 2008 underscored the critical need for robust corporate governance mechanisms to bolster firm performance, a sentiment echoed by Kirkpatrick (2009).

The composition and functionality of corporate boards are pivotal in ensuring effective internal controls. A board's size can influence its efficiency; smaller boards may struggle with resource constraints, while larger boards may face decision-making inertia due to diverse opinions and slower consensus-building processes. The latter scenario is particularly problematic in dynamic

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and globalized business environments, where agility and decisiveness are paramount (Al-Matari *et al.*, 2014; Yan *et al.*, 2021).

Moreover, the independence of the board and the presence of non-executive directors (NEDs) are salient factors that can significantly impact firm performance. Board independence is often associated with enhanced oversight and reduced agency conflicts, while NEDs are expected to contribute external expertise and objective judgment. However, the efficacy of these roles is not universally agreed upon, with some studies suggesting a positive impact, others indicating a negative relationship, and some finding no significant effect at all.

In Oman, instances such as the financial downturns of Oman and Emirates Investment Holding, National Rice Mills SAOG in 2001 and 2002, respectively, serve as stark reminders of the consequences of inadequate corporate governance (Alabdullah *et al.*, 2021; Essel & Addo, 2021). These events have catalyzed a reevaluation of board structures, emphasizing the need for a balanced approach that leverages the strengths of both executive and non-executive board members without compromising operational efficiency (Zureigat *et al.*, 2024).

In light of these considerations, this study seeks to explore the nuanced effects of board size, board independence, and the proportion of non-executive directors on firm performance in the Omani context. The aim is to contribute to the discourse on corporate governance by empirically examining these relationships and offering insights that may inform policy and practice in Oman and similar economies.

### Research Questions

The overarching question guiding this research is: What is the impact of board composition on firm performance? This broad inquiry encompasses several interrelated aspects of board structure, each with its own set of sub-questions:

**Board Size:** How does the size of the board affect the performance of firms in Oman?

Does a smaller board correlate with more effective decision-making and better firm performance?

Conversely, do larger boards benefit from a wider range of expertise and networks, thereby enhancing firm performance?

**Board Independence:** What is the influence of board independence on the operational success of Omani firms?

How does the presence of independent directors contribute to the governance and performance outcomes of firms?

Are there any discernible differences in performance metrics between firms with higher versus lower proportions of independent directors?

**Non-executive Directors:** How do non-executive directors impact the performance of firms?

In what ways do non-executive directors mitigate agency conflicts and enhance firm performance?

What is the relationship between the proportion of non-executive directors and the various measures of firm success?

The value of this research lies in its empirical contribution, offering fresh insights into the roles and importance of corporate governance factors within the Sultanate of Oman. The study's findings will have significant implications for stakeholders involved in Omani business. Corporate managers and board directors can leverage these insights to make informed decisions that improve governance practices and enhance firm performance and shareholder value. Policymakers and regulatory authorities will gain a deeper understanding of the dynamics shaping corporate governance in Oman, enabling them to develop policies and regulations aimed at reducing corporate failures through increased transparency, accountability, and sustainable growth.

Investors and financial analysts will benefit from a clearer understanding of the relationship between board composition and corporate success, leading to sounder investment decisions and a more accurate assessment of the governance structures of Omani firms. Thus, this research not only enriches the body of knowledge on corporate governance in Oman but also offers improved recommendations for corporate governance practices in other emerging economies. Understanding the development of corporate governance systems in countries with varying economic growth levels is crucial for driving business environment changes and creating trends for further development.

In sum, this study aims to provide a significant and meaningful addition to the extant body of knowledge on corporate governance, informing practitioners of best practices that enhance company board structures and promote the efficiency of firms in Oman.

### LITERATURE REVIEW

#### The Impact of Board Size on Firm Performance

The discourse on the optimal board size for enhancing firm performance is a subject of extensive debate within corporate governance research (Almashhadani & Almashhadani, 2023). In the context of Oman, this discussion takes on unique dimensions due to the country's specific economic and regulatory environment. The literature presented a dichotomy of views, with some scholars advocating for smaller boards that facilitate swift decision-making and cost efficiencies, while others highlighted the benefits of larger boards that bring diverse expertise and resources (Bawazir *et al.*, 2021). Technological advancements and changes in organizational structures have led firms to favor smaller boards, which are believed to be more cost-effective and efficient in communication and decision-making (Almashhadani & Almashhadani, 2023). Larger boards incur higher agency costs and may be less effective compared to their smaller counterparts. Resource dependence theory perspective, asserting that larger boards offer a wider range of skills, business contacts, and expertise (Elsayed, 2011).

However, empirical evidence presents a more nuanced picture. Yermack (1996) found a significant negative relationship between board size and firm performance in American firms, measured by Tobin's Q. This finding is supported a negative relationship between board size and firm performance as measured by ROA in Finnish firms. These studies suggest that there may be diminishing returns to board size, where the complexity and coordination costs outweigh the potential benefits of additional board members (Fernández-Temprano & Tejerina-Gaite, 2020).

In contrast, Abdul Manaf *et al.* (2014), in their study of Malaysian firms, found a positive impact of board size on firm performance. Firms listed in the UAE, reported a non-significant impact of board size on firm performance. These findings indicate that the relationship between board size and firm performance may be contingent on the specific context and governance practices of the

region (Almarayeh, 2023).

The Omani corporate landscape provides a fertile ground for further investigation into this relationship. The Sultanate has witnessed its share of corporate governance challenges, which underscores the importance of effective board structures. As Oman continues to evolve its corporate governance framework, studies like the present one are crucial in informing policy and practice, ensuring that board compositions are optimized to enhance firm performance and resilience against economic adversities (Abdul Manaf *et al.*, 2014).

This Literature review section synthesizes various perspectives and empirical findings on the topic, providing a balanced overview. It also aligns with the broader themes of the study, emphasizing the importance of contextual factors in determining the optimal board size for firms in Oman (Almashhadani & Almashhadani, 2022).

**Table 1:** Key Insights from Previous Research

Author(s)	Year	Sample	Findings	Theoretical Framework	Relevance to Study
Yermack	1996	452 American firms	Found a negative relationship between board size and firm performance measured by Tobin's Q.	Agency Theory	Suggests smaller boards may be more effective.
Eisenberg <i>et al.</i>	1998	879 firms in Finland	Observed a negative relationship between board size and firm performance as measured by ROA.	Agency Theory	Supports the idea that larger boards may hinder performance.
Jensen	1993	Conceptual	Argued for an inverse relationship between board size and effectiveness, recommending a maximum of eight members.	Agency Theory	Provides a benchmark for optimal board size.
Abidin <i>et al.</i>	2014	75 companies on Bursa Malaysia	Reported a positive impact of board size on firm performance.	Resource Dependence Theory	Contrasts with findings that advocate for smaller boards.
Haniffa and Hudaib	2006	Not specified	Associated larger boards with a range of skills and expertise.	Resource Dependence Theory	Highlights the benefits of larger boards.
Aljifri and Moustafa	2007	51 firms in UAE	Found a non-significant impact of board size on firm performance.	Not specified	Indicates that board size may not always be a determinant of performance.
Adams & Mehran	2012	Bank Holding Companies	Examined bank board structure and performance, noting additional regulations in the financial sector.	Not specified	Relevant for excluding financial firms from the study.
De Haan & Vlahu	2012	Survey	Discussed corporate governance of banks and additional regulations.	Not specified	Justifies the exclusion of financial firms from the sample.

### The Impact of Board Independence on Firm Performance

A board of director is considered more independent if it has more non-executive directors. However, GCC codes of corporate governance draw a line between board independence and non-executive directors. Being a non-executive director does not automatically make you an independent director. Article (1) of Oman code for corporate governance (2003), defines an independent director, as “He or she or any of his /her first degree has not occupied any senior position (such as the Chief Executive Officer, the General Manager or similar posts) in the company for the last two years. Also, he or she should not have had any relations, with the company, its parent company, or its affiliated or sister companies which could result in financial transactions”. Furthermore, article (3) of Oman code for corporate governance requires a minimum of 1/3rd of the total strength of the board (subject to a minimum of 2) to be comprised of independent directors (Appendix A).

Fooladi and Shukor (2012) in a recent study conducted in Malaysia found that board independence is positively correlated with firm performance using Tobin Q. However, the relationship is found to be negative with ROA. Supporting Fooladi and Shukor (2012) findings Leung *et al.* (2014) also found evidence of strong and positive impact of board independence on firm performance. The above results are consistent with Weir *et al.* (2002) finding in a study conducted using a sample of UK listed firms that directors’ independence has a positive but marginally statistically significant relationship with firm performance . In contradiction with agency theory propositions and recommendations of Oman code for corporate governance (2003) and contrary to the above findings, Klein *et al.* (2005) found that board independence has no impact on firm performance. These

results are in line with the findings of researchers, such as (Abdullah, 2004; Hermalin & Weisbach, 2001; Bhagat & Black, 2002).

In contrast, Agrawal and Knoeber (1996) found a statistically significant negative relationship between directors’ independence and Tobin’s Q. However, in the same study they reported insignificant relationship of board independence with profitability measures. Similar to the findings of Klein (2002a), they reported evidence of a statistically significant negative association between board independence and change in equity market value. However, the result is statistically insignificant when he uses ROA and market returns as proxies for firm performance. In summary, the review of empirical research literature on the impact of board independence on firm performance is not yet conclusive (Bhagat & Black, 1999).

The results vary from evidence of a positive relationship to negative relationship or no relationship at all. Such differences could be due to using data for limited time horizon or could be a result of endogeneity since; endogeneity test has not been performed by most of prior researchers in this area (Ntim, 2009). The studies that show negative relationship or no relationship are in contradiction with best practice for corporate governance, and, of course, the recommendation of Oman corporate governance code (2003). It is also noted that most researchers used Tobin’s Q and ROA (Iturriaga & Crisóstomo, 2010; Lei & Deng, 2014; Rashid & Islam, 2008; Yaser & Denise, 2012). These two proxies do not explain other important aspects of performance as mentioned earlier. Based on the above, it can be concluded that empirical research findings regarding board independence are mixed. Table 2 provides a summary for some of the articles reviewed on the linkage between board independence and firm performance.

**Table 2:** The Impact of Board Independence on FP

NO	Author	Finding/Argument
<b>Positive Relationship</b>		
1	Leung <i>et al.</i> (2014)	There is strong and positive impact on firm performance using ROA as proxy for firm performance
2	Fooladi and Shukor (2012)	Board independence is positively correlated with Tobin Q, but negative with ROA
3	Weir, Laing, and McKnight (2002)	The relationship is positive but marginally statistically significant relationship with firm performance.
<b>Negative Relationship</b>		
4	Yermack (1996)	There is statistically significant negative relationship with Tobin’s Q,
5	Agrawal and Knoeber (1996)	
6	Klein (2002a)	
There is a significant negative result with change in equity market value. The result is statistically insignificant when he uses ROA and market returns		
<b>Insignificant/No Relationship</b>		
7	Klein <i>et al.</i> (2005)	Board independence has no impact on firm performance.
8	Abdullah (2004)	
9	Hermalin and Weisbach (2001).	

Based on the literature, the impact of board independence is mixed. There is strong theoretical support from agency theory and resource dependence theory that the board independence has a positive impact on firm performance.

**The Impact of Non-Executive Directors on Firm Performance**

According to agency theory, using more NEDs is a mechanism that can help in mitigating the agency conflict by exerting more control on management (Fama & Jensen, 1983; Jensen, 1993; Lipton & Lorsch, 1992). In the same direction, following a resources dependence theory, proponents of having more NEDs on boards argue that using more NEDs is positively linked with firm performance. They view NEDs as expert in their domain and they can bring valuable experience and talent and relationships to the board that can help in furthering company business (Chhaochharia & Grinstein, 2009; Haniffa & Hudaib, 2006).

Contrary to the above two arguments, proponents of the stewardship theory argue that having more NEDs could have a negative impact on firm performance, claiming that NEDs have less knowledge of the firm than inside directors (Bozec, 2005). Furthermore, opponents to having more NEDs in the board often argue that NEDs are normally executive or board members at other companies and as such they do not have enough time to devote for the company (Jiraporn *et al.*, 2009). It is also believed that non-executive directors can play a vital role in protecting shareholders' wealth decision-making and control (Hermalin & Weisbach, 1988; John & Senbet,

1998). Rosenstein and Wyatt (1990) find that boards with high percentage of outside directors are positively correlated with firms' performance. Similarly, Baums (1994) and Heenetigala (2011) also find that higher percentage of NEDs on board committees positively affect company performance. This finding is in line with the recommendation of Oman code for corporate governance (2003) Article (3) which requires that the board shall be comprised of a majority of non-executive directors. In contrast, Hermalin and Weisbach (1991) and Bhagat and Black (2001) found that there is no significant relationship between the proportion of NEDs and firm performance. Different than the above two streams of findings, Fosberg (1989) proxying the ratio of sales to total assets for firm performance, found that firms with majority outside directors have a lower sales to total assets ratio than their counterparts. Table 3 provides examples of previous research findings on the relationship between NEDs and firm performance.

The above review of the literature demonstrates that empirical research literature has been inconclusive regarding the impact of non-executive directors on firm performance. However, from an agency theory perspective it can be reasonably argued that the efficacy of a board relies on the most favorable mix within inside and outside directors. The codes of corporate governance of Oman, Qatar, Saudi Arabia and UAE require the majority of shareholders to be non-executive directors. Only Bahrain code for corporate governance requires that 50% of board members should be non-executive directors.

**Table 3:** The Impact NEDS on FP

NO	Author	Country	Finding/Argument
<b>Positive Relationship</b>			
1	Heenetigala (2011)	Sri Lanka	Higher percentage of non-executive directors positively affect company performance
2	Baysinger and Hoskinsson, (1990)	USA	There is evidence of direct and significant relationship between higher proportion of NEDs and firm performance.
3	Baums, (1994)	Germany	There is evidence of significant relationship between higher proportion of NEDs and firm performance.
5	Cotter <i>et al.</i> (1997)	USA	NEDS presence is positively related to shareholders' wealth
<b>Negative Relationship</b>			
6	Fosberg (1989)	USA	Firms with majority outside directors have a lower sales to total assets ratio than their counterparts
<b>Insignificant/No Relationship</b>			
4	Bhagat and Black (2002)	USA	Percentage of NEDs does not impact firm performance.

The above review revealed that having higher proportion of non-executive directors can bring about more control, more accountability and more experience that can help in implementing monitoring and control over executive management. Moreover, the effect of having few good executive directors should not be ignored completely since they are expected to bring more internal knowledge of firm business and critical success factors as insiders to

the firm. Based on the above the researcher expects that the presence of more NEDs on the board of directors to have a positive relationship with firm performance.

**Hypothesis Development**

The dimension of board size and its consequential impact on firm performance has garnered considerable scholarly attention, with a diverse array of findings that span

across different theories and empirical contexts (Nahar *et al.*, 2022). Proponents of smaller boards, drawing upon agency theory, posit that larger boards are associated with heightened agency costs, potentially detracting from firm performance (Bawazir *et al.*, 2021). Conversely, advocates of larger boards, informed by resource dependence theory, argue that the breadth of expertise and knowledge inherent in larger boards could positively influence firm performance (Roszaini Haniffa & Hudaib, 2006). The Omani corporate governance landscape presents a unique case, as the Oman Code does not stipulate a definitive board size, allowing firms the autonomy to determine their board composition (Rehman, 2021). This regulatory flexibility necessitates an examination of board size effects within this specific governance environment. Empirical evidence is divided into three streams: the first suggests that smaller boards are more efficacious, particularly in the context of U.S. firms (Yermack, 1996); the second stream posits that larger boards may be advantageous (Abdul Manaf *et al.*, 2014); and the third stream indicates an insignificant relationship between board size and firm performance (Aljifri & Moustafa, 2007). Notably, prior research has often overlooked critical performance aspects such as short-term liquidity and the probability of firm failure.

Given the mixed results and the gaps identified in the literature, the following hypothesis is proposed for empirical testing within the Omani context:

### Hypothesis

There is a negative and statistically significant relationship between board size and firm performance in Omani firms. Specifically, larger board sizes are hypothesized to be associated with lower performance metrics, such as Return on Assets (ROA), Return on Equity (ROE), Return on Invested Capital (ROIC), Net Profit Margin Percentage (NPMP), Current Ratio, Tobin's Q, and Altman's Z score, reflecting the agency theory's perspective on the inefficiencies of larger boards. This hypothesis aims to contribute to the ongoing discourse by providing empirical evidence from the unique regulatory and economic setting of Oman, thereby enriching the understanding of corporate governance's role in firm performance (Almashhadani & Almashhadani, 2023).

### H1

There is a positive relationship between board size and firm performance

### Non-executive Directors and Firm Performance

From an agency perspective, having a higher percentage of NEDs is very important in mitigating the agency conflict by exerting more control over management (Bennedson *et al.*, 2008). As explained in section 2.8.3.3 the empirical research literature has been inconclusive regarding the impact of non-executive directors on firm performance. Also proponents of resource dependence theory, argue that using more NEDs is positively linked to

firm performance, due to the fact that NEDs are experts in their domain and they are expected to bring valuable experience, talent and perhaps business relationships to the board that can help in furthering company business (Roszaini Haniffa & Hudaib, 2006).

Oman code for corporate governance (2003) Article (3) requires that the board shall be comprised of a majority of non-executive directors and those non-executive directors and independent directors shall be identified in the annual report. Following either agency theory or resource dependence theory, having more NEDs in the board is preferable, leading to the third hypothesis:

### H2

Non-executive directors have a positive and statistically significant impact on firm performance.

### Board Independence and Firm Performance

Both agency theory and resource dependence theory explains the potential positive impact of having independent directors on firm performance. Moreover, Article (3) of Oman code for corporate governance highlighted the importance of board independence by requiring a minimum of 1/3rd of the total strength of the board (subject to a minimum of 2) shall comprise of independent directors, emphasizing the importance of board independence.

As explained by a stream of researchers, such as Yermack (1996), Agrawal and Knoeber (1996) and Klein (2002a) reported an evidence of a negative relationship between board independence and firm performance. Another, stream of researchers, such as Klein *et al.* (2005), Nahar Abdullah (2004) and Hermalin and Weisbach (2001) found that board independence has impact on firm performance at all. In line with the recommendation of Oman code for corporate governance and the propositions of agency theory that independent directors mitigate agency conflict by enhancing monitoring over executive management, a third stream of researchers, such as Fooladi and Shukor (2012); Leung *et al.* (2014), and Weir *et al.* (2002) found an evidence of a positive relationship between board independence and firm performance. It is also worth mentioning that most researchers used Tobin's Q and ROA. These two proxies do not explain other important aspects of performance as measured earlier. Thus, the following hypothesis is proposed;

### H3

Board independence has a positive and statistically significant impact on firm performance

## MATERIALS AND METHODS

### Data Collection

This section delineates the methodology employed for data collection, encompassing the number of firms, the duration of the study, the distribution of the firms under scrutiny, and the data sources utilized.

### Sample and Years of the Study

The sample encompasses all companies listed on the Muscat Securities Market (MSM) over a decade, from 2012 to 2022. The year 2003 marks the enforcement of the corporate governance code, providing a baseline for assessing the code's impact on firm performance. The study's temporal scope ensures a robust dataset for statistical analysis. Financial sector firms are excluded due to their adherence to additional regulatory measures imposed by the Central Bank of Oman (CBO), which could impede comparability with non-financial entities (Adams & Mehran, 2012; De Haan & Vlahu, 2012). The MSM comprises approximately 118 firms; after excluding 34 financial firms and 4 firms with incomplete data, the final sample consists of 80 non-financial firms, representing 95% of the total non-financial firms on the MSM.

### Data Sources

Data were collated from three primary sources:

- (i) DATASTREAM,
- (ii) Firms' annual reports, and
- (iii) Corporate governance reports.

Mandatory annual disclosures by listed companies provide insights into compliance with the Oman corporate governance code (2002). Notably, DATASTREAM served as the primary repository for firm performance and control variables, supplemented by annual reports for any missing data. Corporate governance information was extracted from both corporate governance reports and annual reports.

### Definition and Measurement of Variables

In alignment with contemporary research, this study measures the following variables:

#### Board Size [BDSZE]

The total number of board members at the end of each year. This measurement is consistent with recent findings that both smaller and larger boards can have distinct implications for various performance metrics (Pucheta-Martínez & Gallego-Álvarez, 2020).

#### Board Independence [BDIND]

The percentage of independent directors on the board. Independent directors are those who do not hold any executive position within the company and are not involved in the daily operations of the firm. This definition aligns with recent research that has examined the relationship between board independence and firm performance, with some studies finding positive associations and others reporting no significant impact (Jentsch, 2019).

#### Non-Executive Directors [NEDs]

The percentage of board members who are non-executive directors. NEDs are directors who are not part of the company's executive management team and typically do not engage in the day-to-day management

of the firm. Recent studies have shown that NEDs can have a positive impact on firm performance by providing valuable expertise and oversight (Sethi *et al.*, 2022).

To further explore the impact of different board sizes on firm performance, additional binary variables are defined as follows:

#### BDSZE2

Equals 1 if the board size is less than 7 (the mean), otherwise 0.

#### BDSZE3

Equals 1 if the board size is between 8 and 10, otherwise 0.

#### BDSZE4

Equals 1 if the board size is more than 10, otherwise 0.

These variables allow for a segmented analysis based on board size categories to assess their differential impact on various financial performance indicators. Similar methodologies have been employed in recent studies that investigate the optimal board size for enhancing firm performance (Pucheta-Martínez & Gallego-Álvarez, 2020; Jentsch, 2019).

#### Board Independence [BDIND]

Board independence is normally measured by the proportion of NEDs to total board members (Abdullah, 2006; Basiruddin, 2011; Dalton *et al.*, 1998; Kiel & Nicholson, 2003; Laing & Weir, 1999; Leng, 2004). Article (1) Oman code for corporate governance (2003) defines an independent "He or she or any of his/her first degree relatives has not occupied any senior position (such as the Chief Executive Officer, the General Manager or similar posts) in the company for the last two years. Also he or she should not have had any relations with the company, its parent company or its affiliated or sister companies, which could result in financial transactions" it also requires the segregation between non-executive directors and independent directors and that more than 33% of board members are independent. For the purpose of the study the board independence is measured by the proportion of independent directors to the total number of board members present at the end of the year in the main analysis. Additional definition is added, in order to examine the impact of a code article specified by Oman code for corporate governance (2003), which is:

BDIND2 = If the percentage of independent board members is more than or equal 33%, BDINDP2 equal 1, if less than 33% BDINDP2 equal 0

#### Non-Executive Directors [NEDs]

Following Mura (2007) and Owusu (2012) for the purpose of the study NEDs is measured as the percentage of the number of non-executive directors of the total number of board members at the end of the year. Oman code for corporate governance (2003) Article (3) requires that the board shall be comprised of a majority of non-executive directors.

**Model Specifications**

The model aims to analyze the impact of board composition on firm performance. It includes variables for board size, board independence, and the percentage of non-executive directors, along with other control variables that may influence firm performance.

$$FP_{it} = \beta_0 + \beta_1 BSZE_{it} + \beta_2 BDIND_{it} + \beta_3 NEDs_{it} + \sum_i \text{nb}i \text{CONTROLS}_{it} + e_{it}$$

Where:

- (  $FP_{it}$  ) = Firm performance, measured by financial metrics such as ROA, ROE, ROIC, NPMP, CRATIO, TOBINQ, and ALTMANZ.
- (  $\beta_0$  ) = Constant term.
- (  $BSZE_{it}$  ) = Board size at time ( t ) for firm ( i ).
- (  $BDIND_{it}$  ) = Board independence at time ( t ) for firm ( i ), measured as the percentage of independent directors.
- (  $NEDs_{it}$  ) = Percentage of non-executive directors at time ( t ) for firm ( i ).
- (  $CONTROLS_{it}$  ) = Control variables at time (t) for firm (i), which may include factors like firm age, industry, leverage, etc.
- (  $e_{it}$  ) = Error term.

The coefficients (  $\beta_1$  ), (  $\beta_2$  ), and (  $\beta_3$  ) represent the impact of board size, board independence,

and the percentage of non-executive directors on firm performance, respectively. The control variables are included to account for other factors that might affect firm performance. The error term captures the variation in firm performance not explained by the model.

Where:

$FP_{it}$  = Firm performance as measured by a suite of financial metrics composed of; ROA, ROE, ROIC, NPMP, the current ratio (CRATIO), Tobin’s Q (TOBINQ) and Altman’s Z (ALTMAN’S Z)

$\beta_0$  = Constant

BSZE = Board size

**Findings**

The findings from OLS multivariate regression analysis as shown the table below provide a nuanced view of the impact of board size on various aspects of firm performance. The results suggest that while board size has a negative and significant relationship with net profit margin percentage (NPMP), indicating that smaller boards may be more efficient in enhancing profitability as a percentage of sales revenues, it does not have a significant impact on shareholder returns as measured by ROE or ROIC, nor on the return on each dollar invested in assets as measured by ROA.

**Table 4:** Descriptive Statistics

NO	Variables	Mean	Median	Standard Deviation	Minimum	Maximum	Skewness	Kurtosis
1	BDSIZE	7.08	7	1.44	4	12	0.62	3.24
2	BDIND	89%	100%	18%	0%	100%	-2.32	9.53
3	NEDs	95%	100%	9%	50%	100%	-1.7	5.46
4	TOTAST(MLN)	33	11.6	72.9	0.6	729.4	6.2	50
5	LNTOTAST	9.5	9.4	1.3	6.4	14	0.33	2.9
6	LEV	0.51	0.47	0.34	0.03	3.1	2.2	13
7	LNLEV	-0.89	-0.77	0.71	-3.5	1.1	-0.59	3.4
8	ROA	0.052	0.06	0.11	-0.48	0.55	-0.39	5.5
9	ROE	0.11	0.12	0.4	-4.5	2.6	-2.7	43
10	ROIC	0.26	0.18	0.42	-1.6	2.5	0.87	5.9
11	NPMP	0.046	0.07	0.46	-2.6	2.3	-2	14
12	CRATIO	2.1	1.4	2.1	0.02	20	3.7	22
13	TOBINQ	1.3	1.2	0.73	-0.07	7.8	3.2	21
14	ALTMANZ	3.1	2.1	3.2	-2.9	24	2	9

*BDSIZE=Board size; BDIND= Board independence percentage; NEDs= non-executive directors percentage; TOTAST= The book value of total assets; LEV= The percentage of total debt to total assets value; LNLEV = The natural logarithm of debt to total assets ratio; ROA= Return on Assets; ROE= Return on Equity; ROIC = Return on Invested Capital; NPMP = Net profit margin as percentage of sales value; CRATIO = Current ratio, which is total current assets divided by current liabilities; Tobin Q = A proxy for firm value; ALTMANZ = A ratio that measures the firms risk of corporate failure*

The Table 4 above summarises numerous classical and essential financial and governance indicators critically important for evaluating the company’s actual performance and organizational and managerial characteristics. Measures like board size, independence and non-executive directors illuminate the governance

landscape. Various profitability efficiency measurements such as return on assets, equity, and invested capital help assess financial health and operational efficiency. In contrast, net profit margins give information on operational performance. Furthermore, indicators like the current ratio and Altman Z-score present an idea

of the financial and credit solvency and the probability of corporate failure. These metrics shown in the table above allow for a better assessment of the company's

governance, financial situation, health, and value – all important for decision-making and relevant strategic planning.

**Table 5:** Pairwise Correlation

Variable	A	B	C	D	E	F	G	H	I	J
A BDSZE	1									
B BDINDP	0.09	1								
C NEDs	0.08	0.46	1							
D ROA	0.12	0.11	0.02	1						
E ROE	0.05	0.04	0.05	0.45	1					
F ROIC	0.16	0.08	0.03	0.79	0.39	1				
G NPMP	0.03	0.04	0.03	0.67	0.27	0.46	1			
H CRATIO	0.2	0.15	0.15	0.26	0.04	0.12	0.28	1		
I TOBINQ	0.09	0.07	0.08	0.27	0.13	0.31	0.04	0.05	1	
J ALTMANZ	0.2	0.14	0.09	0.51	0.16	0.41	0.29	0.43	0.45	1

The pairwise correlation Table 5 also shows patterns in the association of the different variables under consideration in the study. When comparing the BDSZE with other board characteristics, we obtain weak negative correlations. In contrast, the correlation with BDINDP is even weaker, which means less robust evidence was found when using this variable in testing the hypothesis. There is only a modest negative correlation between the BDSZE and the NEDs variable, which forms slightly stronger evidence compared to the BDINDP. Having reviewed the concept of financial performance and examining whether it has a weak, moderate or strong correlation with other variables, it is possible to state that there are relatively low but positive levels of correlation

between ROA and ROE financial performance indicators. However, return on invested capital (ROIC) confirms the highest level of relations coefficients with a net profit margin (NPMP) and Tobin's Q (TOBINQ), suggesting that they might have certain common antecedents on financial performance.

Also, Altman Z-Score has a moderate positive correlation with the ROIC and ROE, implying the relationship between the soundness of economic health and profitability performance. In sum, such correlations present an understanding of how and where CG mechanisms and different FP measures are related to guide further research and employ it for the current strategic management.

**Table 6:** OLS Regression Results

Coefficient (t-statistics)								
Row	Variables	ROA	ROE	ROIC	NPMP	CRATIO	TOBINQ	ALTMAN Z
1	BDSZE	0.0008867	0.0059004	0.0068548	-0.023986	0.2181865	0.0380318	0.177244
		-0.31	-0.52	-0.64	(-1.91)*	(4.26)***	(1.87)*	(2.67)***
2	BDIND	0.0330789	0.0822056	0.0382816	-0.023891	0.3816807	0.0579966	0.3701482
		-1.37	-0.86	-0.42	(-0.23)	-0.89	-0.34	-0.66
3	NEDs	-0.00491	-0.245642	0.1688816	0.2237611	3.238434	0.7941605	2.915489
		(-0.11)	(-1.35)	-0.98	-1.1	(3.93)***	(2.42)**	(2.73)***
4	TOTAST	2.45E-07	2.36E-07	1.95E-06	4.74E-07	-2.08E-06	0.0000011	0.00000192
		(4.49)***	-1.09	(9.55)***	(1.98)**	(-2.13)**	(2.85)***	-1.52
5	LNLEV	-0.051137	0.0006622	-0.112894	-0.166443	-1.427344	0.2051514	-3.011077
		(-9.48)***	-0.03	(-5.6)***	(-7.03)***	(-14.82)***	(5.36)***	(-24.11)***
6	INTERCEPT	-0.030275	0.0120882	-0.163381	-0.272214	-5.317258	0.455088	-4.168512
		(-0.62)	-0.06	(-0.9)	(-1.28)	(-6.14)***	-1.32	(-3.71)***
	Adj. R <sup>2</sup>	20%	7%	26%	11%	33%	11%	51%

\*\*\* are significant at  $p < 0.01$ ,

\*\* are significant at  $p < 0.05$  and \* at  $p < 0.10$

The Table 6 provided coefficients and their associated t-statistics offer insights into the relationships between

variables and financial performance metrics. Among these variables, board size (BDSZE) appears to have a positive

but insignificant relationship with ROE and ROIC. The independence of the board (BDIND) has weak or negative correlations to various financial measures. On the other hand, for most of the indicators, non-executive directors (NED) estimation shows a positive correlation, which suggests their role in corporate profitability and efficiency. TOTAST is positively correlated with the dependent variables, namely the ROA and ROIC, which are key indicators of total asset productivity. Further, it

established that several financial-related variables have significant inverse relations with leverage, as indicated by LNLEV and shows the risk of using high levels of debt. The intercept term reflects the base effect on financial performance when other variables are held constant. Overall, these coefficients provide valuable insights into the drivers of financial performance and the significance of governance structures in shaping corporate outcomes.

**Table 7:** Synthesis of Findings

Performance Metric	Impact of Smaller Board Size	Impact of Larger Board Size	Impact of Board Independence	Impact of Higher Percentage of NEDs	Significance
Net Profit Margin Percentage (NPMP)	Higher profitability margins	Less profitable	No significant impact	Positive impact on firm performance	Negative and significant for board size; Positive and significant for NEDs
Current Ratio (CRATIO)	Not specified	Better short-term liquidity	No significant impact	Positive impact on firm performance	Positive and significant for board size and NEDs
Tobin's Q (TOBINQ)	Not specified	Higher market value	No significant impact	Positive impact on firm performance	Positive and significant for board size and NEDs
Altman's Z score (ALTMANZ)	Not specified	More resilience to corporate failure	No significant impact	Positive impact on firm performance	Positive and significant for board size and NEDs
Return on Equity (ROE)	No significant impact	No significant impact	No significant impact	No significant impact	Insignificant
Return on Invested Capital (ROIC)	No significant impact	No significant impact	No significant impact	No significant impact	Insignificant
Return on Assets (ROA)	No significant impact	No significant impact	No significant impact	No significant impact	Insignificant

Table 7 synthesizes the study's findings, showing that while larger board sizes are associated with better liquidity, market value, and resilience, they are less effective in terms of profitability margins. Board independence does not show a significant impact on the performance metrics used in this study. However, a higher percentage of NEDs is positively associated with firm performance across several metrics, underscoring their potential value in corporate governance. Interestingly, the analysis reveals that larger boards are positively associated with firm liquidity, firm value, and resilience to corporate failure. This is evidenced by the positive and significant relationships with the current ratio (CRATIO), Tobin's Q (TOBINQ), and Altman's Z score (ALTMANZ), with R-squared values of 33% and 51% for CRATIO and ALTMANZ, respectively. These findings suggest that larger boards may contribute to better short-term liquidity and higher market value, and they may also provide a buffer against corporate failure. However, the study's hypothesis that board size has a negative impact on firm performance receives limited

support, as the negative effect is only observed with NPMP. The lack of significance in the relationship between board independence and firm performance indicators suggests that the percentage of independent board members does not necessarily correlate with the performance measures used in this study. The descriptive statistics for board size among companies listed on the Muscat Securities Market (MSM) indicate an average board size slightly above seven members, with a median of exactly seven, suggesting that half of the firms have boards composed of seven members or more. The distribution of board size appears to be approximately normal, with a skewness of 0.62 and a kurtosis of 3.24, indicating a smoother distribution. These findings contribute to the broader understanding of corporate governance in Oman, highlighting the complex relationship between board composition and firm performance. They underscore the importance of considering the specific roles and functions of board members when evaluating the effectiveness of board structures in enhancing firm performance.

## Discussion of Findings

### Board Size

The empirical findings of this study offer a nuanced perspective on the relationship between board size and firm performance, particularly within the context of Omani corporations. The negative and statistically significant association between board size and Net Profit Margin Percentage (NPMP) corroborates the agency theory's postulation that larger boards may impede effective management oversight, potentially leading to suboptimal financial performance (Hermalin & Weisbach, 2001; Yermack, 1996).

Conversely, the positive and statistically significant relationships observed between board size and the Current Ratio (CRATIO), Tobin's Q (TOBINQ), and Altman's Z score (ALTMANZ) suggest that larger boards contribute positively to short-term liquidity, market valuation, and resilience against corporate failure. This aligns with the resource dependence theory, which posits that the diversity and breadth of experience provided by larger boards can be instrumental in enhancing business operations and overall firm performance (Abdul Manaf *et al.*, 2014; Roszaini Haniffa & Hudaib, 2006).

The absence of a significant relationship between board size and profitability measures such as Return on Assets (ROA), Return on Equity (ROE), and Return on Invested Capital (ROIC) indicates that these aspects of firm performance may be influenced by factors beyond the scope of board composition. This finding is consistent with the results of Aljifri and Moustafa (2007) who reported a non-significant impact of board size on firm performance in their study of UAE firms.

This study contributes to the extant literature by providing evidence of the positive impact of larger board size on firm short-term liquidity and the probability of avoiding corporate failure, a dimension not previously explored in depth. The implications of these findings are significant for corporate governance practices, suggesting that the optimal board size may vary depending on the specific performance metrics of interest to stakeholders.

Larger boards may not necessarily enhance certain profitability measures; they appear to play a crucial role in bolstering a firm's liquidity, market value, and stability. These insights are particularly valuable for Omani firms and regulators, as they navigate the complexities of corporate governance to foster robust and resilient business environments.

### Board Independence

Although, conventional wisdom is in support of a positive relationship of board independence and firm performance, this study, and several prominent researchers have provided evidence of a negative or insignificant relationship of board independence to firm performance (Agrawal & Knoeber, 1996; Bhagat & Black, 2002; Yermack, 1996). This result can be explained by the following reasons; the first reason is that independent directors may not be truly independent directors, as they

may have special relationships with the CEO or other members of executive management, or they could have been in the board for too long and as a result they are not independent enough (Abdullah, 2004; Bhagat & Black, 2002; Mura, 2007). The second reason is that, independent directors are mostly outside directors who are too busy to focus to exercise their monitoring and advisory roles as board members because they are too busy (Falato *et al.*, 2014; Jiraporn *et al.*, 2009). The third reason is that outside directors may have little knowledge about the firm as compared to inside directors, and because of such information asymmetry, decisions taken by independent directors may be suboptimal compared to decisions taken by inside directors (Healy & Palepu, 2001; Klein, 2002b; Klein *et al.*, 2005; Pratt *et al.*, 1985).

This result supports the findings of Klein *et al.* (2005), Abdullah (2004), Hermalin and Weisbach (2001), and Bhagat and Black (2002) who all found that board independence has no impact on firm performance. In spite of using a wider set of financial performance indicators, a positive relationship between board independence and any of these seven financial performance indicators cannot be substantiated. The result is also not in line with the recommendations of article (3) of Oman code for corporate governance which requires that at minimum 1/3rd of the total strength of the board (subject to a minimum of 2) shall be comprising of independent directors. However, the study result also added two extra findings regarding the relationship between board independence and firm short-term liquidity and board independence and firm probability of corporate failure. The results of OLS multiple regressions reveal that board independence has no significant impact on both firm short-term liquidity as measured by the current ratio and firm probability of corporate failure as measured by Altman's Z.

### Non-Executive Directors

The study findings regarding impact of having majority non-executive directors on firm performance revealed that non-executive directors have a positive and significant impact on firm performance as measured by the current ratio, Tobin's Q and Altman's Z score. This result is very important and it is in line with the recommendation of Article (3) of Oman code for corporate governance (2003) which requires that the board shall be comprised of a majority of non-executive directors (Rehman, 2021). The result also supports the study hypothesis (4) that there is a positive and significant relationship between the existence of majority non-executive directors and firm performance.

The positive and significant relationship of NEDS with firm performance can be explained by both the agency theory and the resource dependence theory (Fama & Jensen, 1983a). From an agency theory prospective NEDs is a mechanism that is very crucial in mitigating the agency conflict by excreting more control on management (Fama & Jensen, 1983b; Jensen, 1993; Lipton & Lorsch, 1992).

Following a resource dependence theory perspective, NEDs as experts in their domain can bring valuable experience and talent and relationships to the board that can help in furthering company business (Chhaochharia & Grinstein, 2009; Roszaini Haniffa & Hudaib, 2006). The above findings support the previous research findings of several author such as (Cotter *et al.*, 1997; Baysinger & Hoskisson, 1990). However, the relationship is found to be insignificant with ROA, ROE, ROIC and NPMP. This result support the findings of Bhagat and Black (2002) that having majority of non-executive directors has no impact on firm performance. The insignificant results on the impact of non-executive directors on profitability measures and the positive impact on short-term liquidity, firm value and the risk of corporate failure could be explained by the fact that enhancing firm profitability may require more inside information about the firm, which might not be available to outside non-executive directors (Healy & Palepu, 2001; Pratt *et al.*, 1985). However, enhancing short-term liquidity, firm value and the probability of corporate failure much depend on directors' expertise, connections with sources of outside finance and reputation in the market (Ros Haniffa, Abdul Rahman, & Haneem Mohamed Ali, 2006; Roszaini Haniffa & Hudaib, 2006; Hillman *et al.*, 2009).

### Implications

**Theoretical Implications:** This study broadens the theoretical framework by integrating a multifaceted approach to board composition, revealing significant insights into the interplay between board size, board independence, and the presence of non-executive directors on firm performance. It has been observed that while a larger board size positively influences short-term liquidity and firm value, an optimal range of 8 to 10 directors appears to maximize performance. However, the study also notes that firms with boards larger than 10 members, though potentially less profitable, demonstrate enhanced liquidity and a stronger resilience to corporate distress.

**Practical Implications:** The practical implications of this study are extensive, affecting corporations, investors, investment advisors, policymakers, and regulators.

**Implications to Corporations:** The findings provide Oman's listed companies with strategic insights for structuring effective boards that optimize firm performance across various metrics. By delineating governance mechanisms that positively correlate with firm performance, corporations can better allocate resources, potentially reducing costs associated with excessive meetings and committees. The study underscores the importance of tailoring board size to the specific performance objectives of a firm. For instance, firms aiming to enhance market value or navigate distress may benefit from a larger board, while those seeking to improve profit margins might find a smaller board more effective due to its decision-making efficiency and cost savings related to director remuneration and incidental expenses.

**Implications to Policy and Regulation:** Regulators and policymakers can draw from these findings to refine corporate governance codes, particularly concerning the recommendations for board independence and the proportion of non-executive directors. The study's insights could inform policies that balance the need for independent oversight with the practical considerations of director availability and firm-specific knowledge.

**Implications to Investors and Advisors:** Investors and investment advisors can leverage the study's conclusions to assess the governance structures of firms more accurately, making informed decisions based on the composition of the board and its alignment with the firm's performance goals.

In essence, this study moves the conversation beyond a binary comparison of board sizes to a nuanced understanding of how board composition—including size, independence, and the presence of non-executive directors—aligns with specific performance objectives. This nuanced perspective is crucial for firms strategizing to enhance particular facets of performance, whether it be market value, liquidity, or profitability.

### CONCLUSION

The inclusion of board independence and non-executive directors further enriches the theoretical landscape. The study finds that board independence does not necessarily correlate with improved firm performance, challenging conventional wisdom and supporting the notion that the effectiveness of independent directors may be context-dependent. Conversely, the presence of non-executive directors has been shown to positively and significantly impact firm performance, particularly in terms of liquidity, firm value, and risk management.

### Limitations of Study

This research has corporate governance variables and corporate performance in the context of emerging economies. However, it is also crucial to look at some limitations of this research. This can have implications in generalizing the findings and their applicability to different organizations. It has several limitations: Firstly, the empirical data have been collected only from the Muscat Security Market, which is a comparatively small market and may restrict the generalizability of the outcomes to other larger and more diverse markets. Finally, developing hypotheses concerning the Oman Code for Corporate Governance framework also further questions the possibility of generalizing the outcomes to countries with different institutional environments.

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