

FOREIGN DIRECTORS AND FIRM FINANCIAL PERFORMANCE: EVIDENCE FROM THE TANZANIAN LISTED COMPANIES

Modest P. Assenga (PhD) Lecturer, Department of Planning and Budgeting, Tanzania Institute of Accountancy (TIA), Cell: +255715-035600, +255754-035600, assengamode@yahoo.com, modest.assenga@tia.ac.tz

ABSTRACT

This study investigates the impact of foreign directors on the financial performance of the Tanzanian listed firms. The study applies balanced panel data Ordinary Least Square (OLS) regression analysis on 120 firm-years observations obtained from the firms' audited annual reports and from the OSIRIS database from 2006 to 2018. The study findings support agency and resource dependence theories that foreign directors have a positive relationship with the firms' financial performance. The findings indicate further that foreign directors enhance firm performance by providing the firm's Board of Directors with effective and efficient overseeing and advice to the CEO and the top management. This study contributes to the understanding of the impact of foreign directors on firm performance and provides researched based evidence to Tanzanian policy makers on the importance of foreign members on the firm's Board of Directors. Unlike the previous corporate governance studies, which focused on developed countries, this study examines the effects of foreign members on the Boards of Directors of listed firms in Tanzania, a developing country where very few corporate governance studies have been conducted. The study recommends policy makers in Tanzania to use the results of this original study while preparing or reviewing Corporate Governance Regulations.

Keywords: Board of Directors; Foreign Directors; Firm Performance;

INTRODUCTION

Background Information

Corporate governance is a key element in controlling and directing firms to improve their performance (Tricker, 2015). It enhances investors' protection and thus increases their wealth (Scheifler and Vishny, 1997). As the backbone of corporate governance, the firm's Board of Directors plays a major role in protecting the investors' interests by ensuring that the firms are monitored and controlled effectively and efficiently (Tricker, 2015). The Board of Directors' strategic decisions influence the firm's performance (Hooghiemstra et al., 2019). In this regard, the Board of Directors performs the basic functions of overseeing the firm's management, advising the management on strategic issues, and providing the firm with the required resources (Mintzberg, 1983; Zahra and Piece, 2009; Adams et al., 2010). However, more recently, Boards of Directors have been blamed for being ineffective in performing these functions resulting in corporate failures (Tricker, 2015). It is claimed that the diversity of board members with different characteristics particularly foreign directors tends to enhance effectiveness of the board in overseeing, advising, and in providing and allocating resource functions (Estelyi and Nisar, 2016).

Board diversity is considered to be an important factor which improves the board monitoring and advisory functions and, hence, the firm's performance (Hooghiemstra et al., 2019). Board diversity and, more particularly, engagement of foreign directors have attracted research interest especially in developed countries. The engagement of foreign directors on the board has been influenced largely by the internationalisation of firms' activities (Oxelheim and Randoy, 2003;

Hooghiemstra et al., 2019). Firms from other countries can benefit from the diverse experience and expertise of foreign board members (foreign directors) (Miletkov et al., 2016). However, the potential role of foreign directors has not been explored fully. Most studies on the potential role of foreign directors focused on developed countries, and little is known on the impact of foreign directors on firms' performance in developing countries (Hooghiemstra et al., 2019). There have been few corporate governance studies in Tanzania (Fulgence, 2014; Assenga et al., 2018), but to the best of the author's knowledge, none of these investigated the impact of foreign directors on firms' performance in Tanzania.

Based on the board roles on monitoring the firm's management and providing resources, this study aims at finding out whether foreign directors have an impact on the firm's financial performance. This study addresses the following arguments: (i) agency theory posits that, foreign directors influence performance through monitoring the firm's management (Pugliese, 2014; Miletkov et al., 2016). And (ii) Resource Dependence Theory argue that, the firm cannot survive on its own due to limited resources and, hence, it needs resources from external environment such as expertise, network, experience, advice, or council (Pfeffer and Salancik, 1978; Mintzberg, 1983).

This study contributes to literature on foreign directors and performance by using Tanzanian data. Also, this study addresses the endogeneity problem, which can result in biasing a corporate governance study. It is possible that board characteristics variables such as foreign directors, are related endogenously to the firm's performance (Wintoki et al., 2012; Miletkov et al., 2016). The rest of this study comprises literature review and development of the hypotheses, the methodology, the empirical findings, discussion, and the conclusion.

LITERATURE REVIEW AND DEVELOPMENT OF THE HYPOTHESIS

The relationship between the board and firm performance is dynamic and complex and may not be explained by one corporate governance theory (Nicholson & Kiel 2007; Pugliese, 2014). Consequently, the author uses agency theory and resource dependence theory to review the previous literature and to develop the research hypotheses. The author uses the agency and resource dependence theories to examine the impact of foreign directors through performance of monitoring, strategic advice, and resource provision. He uses these theories, also, to develop the hypotheses from the previous literature.

Agency theory, which was developed due to agency problems caused by the separation of ownership and control, has attracted the attention of many corporate governance researchers. Agency theorists believe that managers are self-centred and opportunists, thus, there is a need of monitoring them to protect shareholders' interests (Fama & Jensen, 1983). Agency theory promotes the board effective monitoring tasks, reduces agency costs, and enhances firm performance (Zahra & Pearce, 1989; Pugliese, 2014). From the agency theory perspective, Oxelheim and Randoy (2003) argue that, due to their foreign expertise, foreign directors can improve the board monitoring function and, hence, improve the firms' financial performance. However, Masulis et al. (2012) contends that geographical distance may limit foreign directors' ability of monitoring the firm's performance effectively and carrying out their advisory function. This inability can lead to information asymmetry and increase monitoring costs and poor attendance to board meetings.

According to Resource Dependence Theorists, on the other hand having foreign directors in the Board of Directors enhances the provision of essential resources needed by the firm to achieve its objectives (Tricker, 2015). The resource dependence theory promotes resources such as experience, expertise, reputation, experience, knowledge and skills, networks of the firms, advice or council, and legitimacy (Pfeffer and Salancik, 1978; Mintzberg, 1983; Hillman and Dalziel, 2003 and Pugliese, 2014). Foreign directors connect the firm with the external environment through providing advice, necessary resources, such as network to markets, expertise and technology, political and social networks, and, hence, improve firm's performance (Mintzberg, 1983; Tricker, 2015). Foreign directors bring human and relational capital to the firm and, hence, improve its financial performance (Hillman and Dalziel, 2003). In addition, they provide the firm with business networks and linkages with the external environment, which helps the board to obtain relevant, valuable, and timely information that is essential for monitoring and advising the companies (Zahra & Pearce, 1989; Ujunwa, 2012; Hooghiemstra et al., 2019).

The findings of previous studies on the impact of foreign directors on firms' financial performance are inconclusive. For example, Hooghiemstra et al. (2019) used a sample of 3249 firm-year observations representing 586 non-financial Nordic listed firms in the period from 2001 to 2018; Hooghiemstra et al. (2019) investigated the relationship between foreign directors and firm performance. Their findings show that, there is a positive relationship between foreign directors and firm performance. Also, findings in other studies (i.e. Masulis et al., 2012; Ujunwa 2012; Estelyi & Nisar 2016) show a positive relationship between foreign directors and firm performance. In this respect, foreign directors may enhance firms' financial performance by providing advice, experience, and knowledge of foreign and new markets. In contrast, using 62,066 firm-year observations from 80 countries in the period from 2001 to 2011, Milectovic et al., (2016) show that foreign directors have a negative impact on the firm financial performance. Elsewhere findings in studies by Jhunjhunwala and Mishra (2012) and Assenga et al (2018) show an insignificant relationship between foreign directors and firm financial performance.

The development of this study's hypothesis based on the agency and resource dependence theories which propose that, due to their diverse background and expertise, foreign directors enhance the board monitoring and strategic advisory roles and, hence, improve financial performance (Ujunwa, 2012; Hooghiemstra et al., 2019). However, foreign directors' ability to monitor and provide the firm with resources may be limited due to their lack of knowledge of the local regulations and the language barrier (Hooghiemstra et al., 2019). However, Ujunwa (2012) and Hooghiemstra's et al. (2019) argue that, foreign directors' expertise and network to the board is essential for directing and controlling the firms effectively. Therefore, based on this argument, the following hypothesis is developed:

H1: There is a positive relationship between Tanzanian listed firms' foreign directors and firms' financial performance.

METHODOLOGY

The data for the study were collected from the OSIRIS database and from the audited annual reports of the firms listed in the Dar es Salaam Stock Exchange (DSE). This study used twenty-three (23) listed firms on DSE by market capitalization in the year ended in December 31, 2018. Seven (7) firms which deal with financial and insurance were excluded from the sample because they operate under a special regulatory environment (Jackling and Johl, 2009; Assenga et al., 2018). In enhancing the balanced panel data, six (6) firms were removed from the sample due to insufficiency financial and directors' information needed to measure the study's variables during the period from 2006 to 2018. This study used balanced panel data because it is likely to reduce the problems of endogeneity and multicollinearity (Darko et al., 2016; Assenga et al., 2018). The final sample comprised panel data of ten (10) firms listed in the DSE from 2006 to 2018 resulting to 120 firm-year observations over the period under review. Year 2006 was chosen because the firms listed in the DSE had fully implemented the requirements of the Tanzanian Company Act 2002 along with the International Financial Reporting Standards (IFRS) (Assenga et al., 2018). Year 2018 was chosen because data were collected in this year. The sample size was reasonably larger than it was the case in previous studies (i.e. Tsamenyi et al., 2007; Weekes- Marshall, 2014; Assenga et al., 2018) that were done in developing countries.

This study used the following model to investigate the impact of foreign directors on the financial performance of the Tanzanian listed firms.

$$Y_{it} = \alpha + \beta_4 FODIR_{it} + \beta_1 BSIZE_{it} + \beta_2 OUTSIDE_{it} + \beta_3 CEOD_{it} + \beta_7 FDEBT_{it} + \beta_8 FMSIZE_{it} + \beta_9 FMAGE_{it} + \epsilon_{it} \quad (1)$$

Where:

Y_{it} is alternatively ROA_{it} and ROE_{it} for i th firm at time t ; α is the intercept, β_i is the regression coefficient of i th firm and ϵ_{it} is the composite error term.

Consistent with other corporate governance studies and since they are convenient in measuring performance (Coşkun and Sayilir 2012; Vintila and Gherghina, 2012; Assenga et al., 2018), this study employs Return on Asset (ROA) and Return on Equity (ROE) accounting measures to measure firms' financial performance (Dalton et al., 1998). This study also uses the ratio of foreign directors to the total number of directors (FODIR) as a proxy of the foreign directors' impact. This is consistent with the approach in a study by Miletkov et al., (2016). As indicated in Table 1 and consistent with Rashid et al. (2010), Estelyi and Nisar (2016) and Hooghiemstra et al. (2019), the current study uses the variables of BSIZE and BOUTSIDE as governance-specific control variables and FMSIZE, FMDEBT and FMAGE as firm-specific control variables. Due to their likely influence on the firms' financial performance, the presence of these variables controls the influence of other explanatory and dependent variables to enhance accurate test of foreign directors on the firms' performance (Rashid et al., 2010; Estelyi and Nisar, 2016) (see table 1).

This study uses the Ordinary Least Square (OLS) model and firm-year unit of analysis to examine the foreign directors' impact of on the financial performance of the listed Tanzanian firms in the twelve (12) years between 2006 and 2018. The OLS model has been widely applied in corporate governance research studies such as Vintilă and Gherghina (2012) and Assenga et al. (2018). Consistent with the previous studies (e.g. Ujunwa, 2012; Assenga et al., 2018; Hooghiemstra et al., 2019), this study uses Fixed effect and Random regressions to address omitted variable bias and any violation of homoscedasticity and no serial correlations assumptions which may bias the OLS results (Gujarati, 2003; Ujunwa, 2012). The results are compared with OLS results.

Table 1: Variable Description

Variables	Acronyms	Descriptions
Independent Variables		
Foreign Directors	FODIR	The proportion of foreign directors to the total number of directors
Control Variables		
Outside directors	BOUTSIDE	The number of outside non-executive directors as a percentage or a proportion of the total number of directors on the board.
Board size	BSIZE	The number of members who comprise the board of directors at the end of a financial year.
Firm debt	FDEBT	Financial leverage (total debt divided by total equity)
Firm size	FMSIZE	Natural logarithm of total assets
Firm age	FMAGE	Natural logarithm of the number of years which the firm has been listed on the Dar es Salaam Stock Exchange (DSE)
Dependent Variables		
Return on assets	ROA	Net income divided by total assets
Return on equity	ROE	Net Income divided by shareholders' equity.

FINDINGS AND DISCUSSION

Descriptive Statistics

Table 2 shows the descriptive statistics of the variables used in the empirical analysis. The average ROA of the Tanzanian listed firms is 16.45 percent and the average ROE is 27.24percent. The proportion of foreign directors on the board is about 41percent. The average board size is seven (7) directors and the average percentage of outside directors on the Board of Directors is 82 percent. This shows a high level of compliance in having a large proportion of outside directors. Furthermore, the mean (standard deviation) of the other variables is as follows: financial leverage 1.8(9.4), firm size 13.3(4.9), and firm age 1.9(0.76). These statistics are consistent with the statistics in Assenga et al. (2018).

Table 2: Descriptive statistics results

Variable	Obs	Mean	Std.Dev.	Min	Max
ROA	120	16.44858	19.26202	-26.28	69.54
ROE	103	27.24058	18.49511	-23.77	58.27
fodir	120	.4093333	.2141418	0	0.8
boutside	120	.8199167	.1593764	.43	1
bsize	120	6.491667	2.264063	3	11
fmdebt	120	1.820917	9.42643	-31.53	96.41
fmsize	120	13.34517	4.910645	6.96	19.97
fmage	120	1.933833	.7689392	0	3.04

Correlation Results

Table 3 shows the correlation matrix results. The findings show that there is a negative correlation between Board size and ROA and a positive correlation with the proportion of outside directors on the Board of Directors (Ujunwa, 2012). This result implies that a small Board of Directors with a large number of outside directors is possibly more effective in monitoring the firm's managers, offering strategic advice, and providing the firm with resources. There is a positive correlation between the proportion of foreign directors on the board, ROA, and ROE. However, there is a negative correlation between the board size, ROA and ROE.

This result indicates that foreign directors on a small Board of Directors are likely to improve the firm's financial performance because of their expertise in monitoring the management and in providing strategic advice (Hooghiemstra et al., 2019). However, there is a negative correlation between firm size, outside directors and foreign directors. This suggests that as the complexity of the firm increases, the board size, and the proportion of outside directors decreases. This is consistent with the findings in a study by Assenga et al. (2018).

There is a negative correlation between firm age and ROE and ROA. This suggests that, because of their higher cost structures, newer firms have possibly higher returns than is the case with older firms. This is inconsistent with the findings in a study by Ujunwa (2012).

The correlation findings justify this study's inclusion of firm age and board size as the control variables. Although the control variables coefficients of BOUTSIDE, FMDEBT, and FMSIZE are not statistically significant with ROA and ROE, they are generally consistent with the findings of previous studies (Oxelheim and Randoy, 2003; Ujunwa, 2012).

Table 3: Correlation matrix

		1	2	3	4	5	6	7	8
1	ROA	1.0000							
2	ROE	0.8530***	1.0000						
		0.0000							
3	boutside	-0.0261	-0.0880	1.0000					
		0.7770	0.3768						
4	bsize	-0.2502***	-0.0609	0.4449***	1.0000				
		0.0059	0.5413	0.0000					
5	fodir	0.4535***	0.4054**	-0.1512	-0.4952*	1.0000			
		0.0000	*	0.0992	0.0000				
			0.0000						
6	fmdebt	-0.1491	-0.1718	0.0740	-0.0184	0.0492	1.0000		
		0.1042	0.0828	0.4217	0.8419	0.5936			
7	fmsize	-0.0832	0.0373	-0.4295***	0.0056	-0.2621***	-0.0082	1.0000	
		0.3665	0.7084	0.0000	0.9518	0.0038	0.9296		
8	fmage	-0.2531***	-0.2138*	0.0681	0.0573	-0.0657	0.0326	0.1717	1.0000
		0.0053	0.0301	0.4598	0.5344	0.4760	0.7237	0.0608	

*** Significant at the 1% level (2-tailed). ** Significant at the 5% level (2-tailed)

Regression results and discussion

Hypothesis H1 proposes that there is a positive relationship between having foreign directors in Tanzanian listed firms and firms' financial performance. As shown in Tables 4 and 5, there is a positive and significant correlation between

the proportion of foreign directors on the Board of Directors and both ROA and ROE. Consequently, hypothesis H1 is accepted. The findings support those in previous studies (i.e. Oxelheim and Randoy, 2003; Ujunwa, 2012; Masulis et al., 2012; Estelyi and Nisar, 2016; Hooghiemstra et al., 2019). However, these findings are inconsistent with the findings in studies by Milectovic et al. (2016) and Assenga et al. (2018).

Theoretically, the findings support the argument in (i) agency theory that, foreign directors provide effective monitoring of the firm's managers to minimize agency costs (Ujunwa, 20102) and (ii) resource dependence theory that, by providing advice, foreign directors enhance the firms' effectiveness and, hence, increase the firms' financial performance (Mintzberg, 1983; Pugliese, 2014; Tricker, 2015). These findings are in line with Masulis's et al., (2012) assertion that, by using their international backgrounds and expertise, foreign directors help in providing the Board of Directors with an effective advisory and monitoring role to the firms.

Table 4: OLS Regression Results

Independent Variables	ROA			ROE		
	Coef.	t	P> t	Coef.	t	P> t
Fodir	42.50895	4.99	0.000***	45.31097	4.54	0.000***
Boutside	22.29171	1.81	0.072	3.538933	0.27	0.786
Bsize	-.7484788	-0.88	0.382	1.748783	1.92	0.057**
Fmdebt	-.3638604	-2.26	0.026**	-.7634863	-0.63	0.532
Fmsize	.636025	1.69	0.093	1.004723	2.44	0.017**
Fmage	-6.302722	-3.13	0.002***	-5.863041	-2.73	0.007***
R2	0.3083			0.2761		
Adjusted R2	0.2715			0.2309		
F-statistics	8.39***			6.10***		
No of Observation	120			103		

*** Significant at the 1% level (2-tailed) ** Significant at the 5% level (2-tailed)

Robustness Tests

Endogeneity is a persistent problem in corporate governance studies and, more particularly, in studies on the relationship between board characteristics and firms' financial performance (Wintoki et al., 2012). Endogeneity can

make OLS findings biased and misleading (Lacker & Rusticus, 2010). According to Wintoki et al. (2012), while there are different causes of endogeneity, the common ones are simultaneity (explanatory variables influence dependent variable and dependent variables influence explanatory variables), omitted variables (influence both dependent and explanatory variables), firms' past performance and decisions. This study applies fixed effects regression to address the potential endogeneity problems.

Table 5: Fixed Effects Regression Results

Independent		ROA			ROE		
Variables	Coef.	z	P> t	Coef.	z	P> t	
fodir	-14.54529	-1.05	0.295	28.64021	1.45	0.150	
boutside	-14.40049	-0.83	0.411	25.72054	1.07	0.287	
bsize	-.073547	-0.04	0.965	-.8814439	-0.38	0.704	
fmdebt	-.1000457	-1.11	0.269	-.504792	-0.46	0.646	
fmsize	-1.2934	-0.49	0.625	-8.636802	-2.43	0.017*	
fimage	-3.168139	-1.65	0.101	-1.191631	0.666	0.666	
R2	0.1604			0.1896			
Adjusted R2							
F-statistics	32.47***			11.98***			
No of Observation	120			103			

*** Significant at the 1% level (2-tailed). ** Significant at the 5% level (2-tailed)

Tables 5, 6, and 7, show the results of the Fixed-Effects, Random-Effects, and Hausman Test models. The Hausman Test indicates that the data set is more consistent with the random-effects model.

Table 6: Hausman fixed and random results (ROA)

	Coefficient		(b-B)	sqrt(diag(V_b-V_B))
	(b)	(B)	Difference	S.E
	fe	re		
Fodir	-14.54529	-5.53532	-9.009968	5.986979
Boutside	-14.40049	-11.48874	-2.911752	6.889708
Bsize	-.073547	-.6876516	.6141046	.8052313
fmdebt	-.1000457	-.108747	.0087013	.0063515
fmsize	-1.2934	-.5296105	-.7637897	2.383217
fimage	-3.168139	-3.667372	.4992325	1.214679

Notes: $\chi^2(6) = (b-B)'[(V_b-V_B)^{-1}](b-B) = 5.03$

Prob>chi2 = 0.5398

The results show that, there is a negative and significant correlation between the firm's age and the firm's financial performance. This result is consistent with the findings in OLS. The findings also show a positive and significant relationship between foreign directors and firms' financial performance. However, the degree of significance is weak. This finding is consistent with the findings of Estelyi & Nisar (2016) and Hooghiemstra et al. (2019). The coefficient of board size was negative and insignificant. This finding is inconsistent with the findings of Guest's (2009) and Kao et al.'s (2019). The OLS findings are reasonably robust to the endogeneity test because of the similarity in the magnitude and direction of both sets of coefficients.

Table 7: Random Effects Regression Results

Independent Variables	ROA			ROE		
	Coef.	z	P> t	Coef.	z	P> t
fodir	-5.53532	-0.44	0.657	28.93604	1.71	0.087
boutside	-11.48874	-0.72	0.473	21.76902	1.02	0.306
bsize	-.6876516	-0.47	0.638	-1.115974	-0.59	0.557
fmdebt	-.108747	-1.21	0.226	-.6686844	-0.61	0.540
fmsize	-.5296105	-0.47	0.640	-.0336496	-0.03	0.979
fimage	-3.667372	-2.48	0.013	-5.927954	-2.82	0.005***
R2	0.1552			0.1317		
Adjusted R2						
Chi2	19.37***			14.65**		
No of Observation	120			103		

*** Significant at the 1% level (2-tailed). ** Significant at the 5% level (2-tailed)

Table 8: Hausman fixed and random results

	Coefficient		(b-B)	sqrt(diag(V_b-V_B))
	(b)	(B)	Difference	S.E
	fe	re		
Fodir	28.64021	28.93604	-.2958267	10.06352
boutside	25.72054	21.76902	3.951523	11.14312
bsize	-.8814439	-1.115974	.2345304	1.319148
fmdebt	-.504792	-.6686844	.1638925	.0737174
fmsize	-8.636802	-.0336496	-8.603152	3.318828
fimage	-1.191631	-5.927954	4.736322	1.768354

Notes: $\chi^2(6) = (b-B)'[(V_b-V_B)^{-1}](b-B) = 7.86$

Prob>chi2 = 0.2487

CONCLUSIONS AND RECOMMENDATION

Corporate governance plays a major role in enhancing firms' performance through providing the firms with effective directions and control of the management (Tricker, 2015). Hooghiemstra et al. (2019) contend that, there is dearth of literature on the relationship between foreign directors and firms' performance. In addition, Fulgence (2014) and Assenga et al. (2018) argue that very few corporate governance studies have been done in Tanzania. With the aim of reducing the existing gap, this study examined the impact of foreign directors on the financial performance of the Tanzanian firms listed in the Dar es Salaam Stock Exchange (DSE). In line with Estelyi and Nisar (2016), this study's findings show that there is a positive and significant relationship between foreign directors and firm financial performance. The study findings highlight the importance of foreign directors in the Board of Directors in terms of discharging their monitoring and advisory roles effectively and efficiently in the Tanzanian corporate environment. Agency and resources theories support the findings of the current study that foreign directors utilize their diverse backgrounds and expertise in enhancing the effectiveness of the Board of Directors' monitoring and advisory roles (Ujunwa, 2012; Hooghiemstra et al., 2019).

This study contributes to literature in corporate governance and, more particularly, to the relationship between foreign directors and firms' performance. In addition, the study findings have important implications for practitioners. For firms, the findings indicate the need of having appropriate number of foreign members in the Board of Directors. It is recommended that, since this study provides academic evidence for current and future corporate governance reforms in Tanzania, the findings will inform the country's policy makers on what needs to be considered in providing appropriate guidance to corporate governance.

As for the limitations of this study, the sample of listed firms was small because Tanzania is a developing country and the size of the DSE stock market is small. Consequently, when comparing to the stock markets of developed countries, the DSE has few listed companies. It is also noteworthy that most corporate governance studies in developing countries use secondary data because of the small size of their stock markets and the liquidity challenges that they face (Weekes-Marshall, 2014). However, the data collected and used in this study were as comprehensive and as accurate as possible. Against this background, the author recommends that future studies should use data from unlisted firms and, in doing so, should use qualitative methods of data collection such as questionnaires, interviews, and boardroom observations.

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