

The Effect of Corporate Governance Proxies on Firm's Financial Performance. an Empirical Analysis from Beirut Stock Exchange

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Abstract: Corporate governance, a system whose structure relies mainly on the firm's direction and its contribution to the overall society. Effective corporate governance plays a key role in increasing the value equity holders through proper alignment of incentives among stockholders and management. Corporate governance utilizes several methods in pledging optimal profitability and ample Return on Investment for shareholders or investors. It also upholds transparency, corrective measures, defines responsibilities at the corporate level, which implicates the relationships between the company's management, the executive board and the shareholders. In quintessence, the quality of corporate governance is a firm's choice without an apparent external cause. If set correctly supported by adequate managerial incentives, shareholders' wealth can be maximized through endorsement of growth opportunities and higher productivity. Investors carefully study the organization's corporate governance to check its viability and to highlight the its strength. Corporate governance is essential in providing feedback to the potential investors, whereby positively perceived corporate governance yields and attracts more and more potential investors. It is imperative to study the relationship between corporate governance proxies and the value of a firm since corporate governance plays a significant role in improving the performance of a firm. This study empirically tests the relationship between Corporate Governance proxies and the firm's financial performance in Beirut stock Exchange aiming to increase the enactments of corporate governance practices to support in maximizing firms' values.

Index Terms: Keywords: Corporate Governance, Firm Value, Beirut Stock Exchange.

I. INTRODUCTION

Corporate governance has proven its importance to the public within a very short period of time primarily due to the focus it portrays on corporations and their behavior. Defining corporate governance is of vast importance, yet challenging since it takes into account financial and human resources. On the financial side, the emphasis is on the financial resources deployed by investors aiming for a decent return on their investment. Hence, profitability is the main argument accentuated. In other words, it provides a set of rules and procedures that aid in protecting the interest of the potential investors. On the other side, recruiting and maintaining good-caliber employees and managers is considered as the other area, which also belongs to corporate governance and that ensures that internal personnel do not act solely for their own benefits and interests, but for the company as a whole entity, ultimately following the direction of shareholders' wealth maximization. Furthermore, corporate governance

stresses on corrective actions, promotes transparency and responsibility at all the levels of the company. That means, it emphasizes on the correlation between the internal and external managing and directing authorities of the organization by clearly defining the relationship between the company's management, executive board, shareholders and stakeholders[17].

From a financial industry perspective, corporate governance precisely the banking industry depicts the way business and affairs are protected by the senior management and the board of directors that helps in the determination of the effects on the corporate objectives by ensuring that banks are complaint with laws and regulations in order to shield the depositors' interests[3].

Ensuring that stockholders, creditors and other stakeholders would receive the expected share based on the company's profits requires certain means of communication and collaboration among the organizations' management and its investors. This is a basic definition of corporate governance, which portrays corporate governance as a possible risk element for stockholders. If the standards are considered deficient, then there would be a high probability that financial stakeholders who are the stockholders may not earn an appropriate return on their investment. This could be either because of tarnished governance practices in intense cases, or ineffective governance practices in less severe situations[15].

Corporate governance is essential in providing feedback to the potential investors, whereby positively perceived corporate governance yields and attracts more and more potential investors, unlike poor governance that causes investors to refrain from investing in their companies[33].

This study focuses on corporate governance proxies and their effect on firm's financial performance of publicly listed firms in Beirut stock Exchange. Content analysis and multivariate regression analysis are used in this study to examine the correlation between corporate governance proxies (Size of the Firm, Leverage, Gearing, Profitability, and Market Capitalization) and the firm's value (Tobin's Q) using 2014, 2015, & 2016 annual reports. The upcoming sections of this paper include: literature review and hypotheses development, research design and methodology, data presentation, statistical analysis and results, and lastly conclusions, limitations, and suggestions for future research.



II. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

To formulate an efficient corporate management and public regulatory policies, it is imperative to study the relationship between corporate governance and the value of a firm. According to, corporate governance plays a significant role in improving the performance of a firm. Furthermore, a direct relationship between corporate governance and the firm performance exists in both developing and developed financial markets[18][19][25].

Developed and developing financial markets are different in terms of social, economic, regulatory structure, and market behaviors. Hence, the relationship between these markets tends to do differ in nature, direction, size and processes of operation[1].

These differences have not been methodically discussed in current existing literature, which challenges developing markets in integrating these variations throughout the analysis of corporate governance and valuation of the firm for a better understanding of the role that corporate governance portrays in affecting the firm's performance and framing the regulatory structure. Throughout research, researchers defined corporate governance in several ways exploring possible correlation between corporate governance and the value of the firm.

Cadbury (1992) defines corporate governance as employed mechanisms to regulate organizations[14]. argues that corporate governance is the tool used to protect the shareholders' interests in the financial market. Furthermore[27], Monks and suggest that corporate governance is the mechanism that can be used by the board of directors to improve the shareholders' value through the control of managerial actions. On the other hand[28], contend that corporate governance is a structure that protects and controls the interest of concerned players within a market[29].

The value of a firm is defined as the amount of utility or benefits originated from the firm's shares by its shareholders[34].

There are many existing and largely-used methods for firm valuation in financial markets, such as discounted cash flow method, adjusted net present value method, equity cash flow method, and weighted average cost of capital method as Another method which relies on Tobin's Q is also important to value firms in financial markets [11][12][13]

used Tobin's Q ratio to determine the value of firms in financial markets throughout their research. Tobin's Q ratio is extensively used in valuing firms in both developed and developing financial markets. It depicts and reveals the financial strength of the firm in a particular financial market. It is defined as the (book value of debt and market value of equity) over the total book value of assets[4][5].

According to the Asian Development Bank, there are several instruments, which are used in financial markets to improve corporate governance and value of the firm. Economic and financial theory indicates that corporate governance affects the value of a firm in both developed and developing financial markets[3][16][31].

A variety of instruments exist for a firm to implement

corporate governance. Each instrument has a different role that contributes for such implementation. These instruments include, the board of directors, size of the board, executive directors, independent directors, chief executive officer, managers, market and its efficiency, political framework, government, regulatory authority and judiciary. The roles of the chief executive officer, executive directors, independent directors, board of directors, and managers are essential in the implementation of the corporate governance structure and in the improvement of the value of the firm if these perform their fiduciaries in an appropriate manner. On the other hand, the roles of the government and the regulatory authority are also important in improving the value of the firm since these authorities have the ability to protect the shareholders' rights besides their capability in sustaining a proper implementation of corporate governance in both developed and developing financial markets[12].

A firm's management may choose to combine several corporate governance instruments rather than using these in isolation in an attempt to further refine the value of the firm. In other words, opportunity cost may be lowered if these corporate governance instruments are effectively combined together. Nevertheless, the combinations tend to differ between developed and developing financial markets.[23][24]

In this study, Tobin's Q would be the dependent variable used to determine the value of the firm in correlation several corporate governance proxies that serve as independent variables such as, the firm's: size, leverage, gearing, market capitalization, and profitability.

A. Hypotheses Development

Referring to literature review, a variety of relevant research questions have been developed., all of which revolve around the effect of corporate governance proxies on firm's value. Henceforward, a very precisely defined research question has been developed as: "What is the effect of corporate governance proxies on firm's valuation of publicly listed firms in Beirut stock Exchange?"

To respond to the main research question, the following hypotheses have been developed[7][8][9][10][35]:

Table I. Hypotheses Development

- H1₀ There is no statistically significant correlation between firm's size and firm's value
- H1₁ The firm's size positively affects the firm's value
- H2₀ There is no statistically significant correlation between firm's leverage and firm's value
- H2₁ The firm's leverage negatively affects the firm's value
- H3₀ There is no statistically significant correlation between firm's gearing and firm's value
- H3₁ The firm's gearing negatively affects the firm's value
- H4₀ There is no statistically significant correlation between firm's market capitalization and firm's value
- H4₁ The firm's market capitalization positively affects the firm's value

- H5₀ There is no statistically significant correlation between firm's profitability and firm's value
H5₁ The firm's profitability positively affects the firm's value

Source: Authors

Discrepancy in literature with regards to the effect of the above herein mentioned independent variables on firm's value was the main trait taken into consideration in this study to evolve the preponderant condition of the publicly listed firms in Beirut stock exchange.

III. RESEARCH DESIGN AND METHODOLOGY

This research is designed as an empirical study of the correlation between Corporate Governance proxies and firm's value of publicly listed firms in Beirut Stock Exchange. The aim of this research is to respond to the main research question through the utility of quantitative methods by way of multivariate regression analysis of content analysis of 2014, 2015, and 2016 annual reports.

A. Target Population and Sampling Method

The target population consists of all publicly listed corporations in Beirut Stock Exchange as of December 31, 2017. This study inspects 100% of the target population due to the following valid reasons:

- Statistical analysis is considered powerful and more effective when increasing the sample size or when using larger true-representative sample size. (Hair et al., 2010);
- The generalizability, reliability, and informative(s) of the findings are highly affected by the sample size. (Hair et al., 2010);
- Sampling 100% of the target population eliminates the risks involved in the various types of sampling, such as sampling bias and sampling errors (Hair et al., 2010).

B. Annual Reports and Content Analysis

There are various researchers who used content analysis of annual reports as the main source of data testing. For instance, Gray et al., 1995; Beattie and Thomson, 2007 used content analysis to examine the effect of Intellectual Capital reporting. While it can be reasoned that the entire practices of a firm's external communication should be observed in case a researcher would like to obtain relevant-reporting, the challenge is the impossibility to conclude with inevitability that all relevant-communications are taken into account (Gray et al., 1995).

Hence, this study assesses the annual reports of all publicly listed firms in Beirut Stock Exchange due to the subsequent reasons:

- Annual reports are contemplated as indispensable source of legitimate information for both external and internal stakeholders [2];
- Annual reports are generated on a periodic basis, usually per annum, and per se, they stipulate a prospect for significant assessments and exploration[32]

The utility of content analysis is ideal in analyzing published information in methodical, unbiased, and consistent modus [26].

Finally, content analysis method is considered to be empirically valid[21][22].

C. Definition of Variables

The dependent variable, the independent variables along with their retained measures are listed in Table II of this section.

Table II. Dependent and Independent Variables

Dependent Variable	Code	Retained Measure
Firm's Value	Tobin sQ	Market value of equity plus the book value of total debt divided by the book value of total assets
Independent Variables	Code	Retained Measure
Firm's Size	FSize	Logarithm of book value of total assets
Leverage	Lev	Total debt divided by total assets
Gearing	Gear	Total debt divided by book value of equity
Market Capitalization	MCa p	Natural Logarithm of the price per share multiplied by the number of shares outstanding
Profitability	Prof	Earnings Before Interest and Taxes in Lebanese Pounds

Source: Authors

D. Data Collection

The 2014, 2015, and 2016 annual reports of all publicly listed firms in Beirut Stock Exchange were downloaded in PDF format in order to extract book-value relevant-financial-data for the following variables[6]:

- Firm's value (Book value of total debt and book value of total assets)
 - Firm's size (Book value of total assets)
 - Leverage (Book value of total debt and book value of total assets)[20]
 - Gearing (Book value of total debt and book value of total equity)
 - Profitability (Earnings Before Interest and Taxes)
- Additionally, the official website of Beirut stock Exchange was used to obtain data for the following variable:
- Market Capitalization (Closing Prices of Stocks and Number of Shares Outstanding)

IV. RESULTS AND DISCUSSIONS

Statistical analysis of this study along with descriptive analysis and regression output are included in this section.

A. Descriptive Analysis

The following table, Table III, shows the descriptive statistics of the dependent and independent variables:

Table III. Descriptive Statistics

Variable	N	Minimum	Maximum	Mean	Std. Deviation
TobinsQ	30	0.11	15.33	2.0552	3.29396
FSize	30	24.02	30.89	27.0754	2.37642
Lev	30	.10	.92	0.6938	0.29829
Gear	30	0.12	11.86	6.2703	4.60445
MCap	30	15.00	27.00	22.4667	3.48131
Prof	30	8.73	11.80	10.2903	1.01775

Source: Authors

Tobin's Q has a minimum frequency of 0.11, a maximum of 15.33, a mean of 2.0608, and a standard deviation of 3.29195. In terms of Firm's



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size (FSize), the minimum value of total assets is 24.02, the maximum value of 30.89, with a mean of 27.0795 in Natural Logarithmic terms, which translate into Lebanese Pounds 26,994,378,000; Lebanese Pounds 25,941,122,742,000 and Lebanese Pounds 576,072,869,967 Respectively. As for Leverage (Lev), the debt ratio has a minimum value of 10%, a maximum value of 92%, and a mean of 69.38%. Gearing (Gear), on the other hand, has a minimum value of 12%, a maximum value of 11.86X, and an average of 6.2703X. In terms of Market Capitalization (MCap), its minimum value is 14, its maximum value is 27, with an average of 21.3333 in Natural Logarithm terms, which translate into a minimum value of Lebanese Pounds 4,710,000, a maximum value of Lebanese Pounds 642,137,400,000 with an average of Lebanese Pounds 5,716,942,663. Finally, in terms of Profitability (Prof), the minimum value is Lebanese Pounds -80,482,776,000, the maximum value is Lebanese Pounds 634,537,385,000 with an average of Lebanese Pounds 113,767,429,433

Following the analysis of the variables as shown herein above descriptively, the following table, Table IV portrays the correlation of the coefficients between the dependent variable and the independent variables of the firms in Beirut Stock Exchange for years 2014, 2015, and 2016 (N=30). Pearson's correlation signifies statistical significance of between Tobin's Q and the independent variables FSize, Lev, Gear, MCap, and Prof.

Table IV. Correlation Matrix

	Tobin's Q	FSize	Lev	Gear	MCap	Prof
Tobin's Q	Pearson Correlation	1				
	Sig. (2-tailed)					
	N	30	30	30	30	30
FSize	Pearson Correlation	-.084	1			
	Sig. (2-tailed)					
	N	30	30	30	30	30
Lev	Pearson Correlation	-.721*	.091	1		
	Sig. (2-tailed)					
	N	30	30	30	30	30
Gear	Pearson Correlation	-.668*	.188	.626**	1	
	Sig. (2-tailed)					
	N	30	30	30	30	30
MCap	Pearson Correlation	.094	-.349	.365	.265	1
	Sig. (2-tailed)					
	N	30	30	30	30	30
Prof	Pearson Correlation	.381*	-.531**	-.227	-.304	.142
	Sig. (2-tailed)					
	N	30	30	30	30	30

N	30	30	30	30	30	30
Pearson Correlation	.381*	-.531**	-.227	-.304	.142	1
Sig. (2-tailed)	.038	.003	.227	.103	.453	
N	30	30	30	30	30	30

** Correlation is significant at the 0.01 level (2-tailed).

* Correlation is significant at the 0.05 level (2-tailed).

Source: Authors

B. Regression Output

This study adheres to the four stages of data assessment as insinuated by Hair et al. (2009):

- Graphical examination of the variables:** All variables were graphically examined ensuring that the requirements of this analysis are met.
- Missing data analysis:** There are no missing data as far as all variables are concerned
- Identification of outliers:** Neither univariate nor multivariate outliers exist in any of the concerned variables.
- All data have been carefully assessed in order to meet the statistical assumptions related to multivariate regression analysis, including:** linearity, normality, homoscedasticity, multicollinearity, and uncorrelated error terms.

Multivariate regression technique will be utilized, which involves multiple linear regression analysis. Hence, the model for regression would be:

$$\text{Tobin's Q} = \beta_0 + \beta_1 \text{FSize} + \beta_2 \text{Lev} + \beta_3 \text{Gear} + \beta_4 \text{MCap} + \beta_5 \text{Prof} + \epsilon$$

1) Coefficient of Determination (R²)

The adjusted R² in the above herein mentioned model is 0.803. This implies that 80.3% of the variation of Tobin's Q, i.e., the firm's value is explained through the variation in the

independent variables, while 19.7% of the variation in Tobin's Q, i.e., the firm's value is explained by other factors that are not present in this model.

2) F-Test

The regression model indicates high statistically-significant results. The F value of 24.641 indicates statistical significance (p-value = 0.000) between the dependent variable and the independent variables at a 95% level of confidence (α = 5%).

3) Regression Tests

Following the application of all classic tests that conform to the regression's requirements, the regression analysis is performed to test this study's hypotheses using SPSS software. Results are presented in the table that follows and explained after that.



Table V. Regression Results

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
	B	Std. Error				Beta	Tolerance
(Constant)	-2.057	1.666		3.281	0.003		
FSize	0.244	0.072	0.353	3.388	0.002	0.625	1.6
Lev	-2.012	0.347	-0.64	-5.794	0.000	0.557	1.794
Gear	-0.119	0.032	-0.405	-3.698	0.001	0.566	1.766
MCAp	0.276	0.052	0.525	5.346	0.000	0.705	1.419
Prof	0.201	0.09	0.225	2.23	0.035	0.668	1.497

Source: Authors

- The intercept β_0 has a value of -2.057 and a t-value of 3.281, which is statistically significant (p-value = 0.003) at the 95% level of confidence ($\alpha = 5\%$).
- All independent variables are statistically significant at the 95% level of confidence ($\alpha = 5\%$)
 - Firm's Size (FSize) (β_1) has a p-value of 0.002
 - Leverage (Lev) (β_2) has a p-value of 0.000
 - Gearing (Gear) (β_3) has a p-value of 0.001
 - Market Capitalization (MCAp) (β_4) has a p-value of 0.000
 - Profitability (Prof) (β_5) has a p-value of 0.035
- Fsize, MCAp, and Prof, have positive coefficients, which indicate positive correlation with the dependent variable Tobin's Q
- Lev, and Gear have negative coefficients, which indicate negative correlation with the dependent variable Tobin's Q

The Unstandardized coefficients indicate that for one unit increase in the independent variable, Tobin's Q, i.e., the Firm's Value will increase or decrease by that amount. Thus, for one unit increase in:

- FSize, Tobin's Q will increase by 0.244 frequencies
- MCAp, Tobin's Q will increase by 0.276 frequencies
- Prof, Tobin's Q will increase by 0.201 frequencies
- Lev, Tobin's Q will decrease by 2.012 frequencies
- Gear, Tobin's Q will decrease by 0.119 frequencies

Based on the above herein mentioned information, the following is the produced regression model:

$$\text{TobinsQ} = -2.057 + 0.244\text{FSize} - 2.012\text{Lev} - 0.119\text{Gear} + 0.276\text{MCAp} + 0.201\text{Prof}$$

C. Hypotheses Verification

1) Hypothesis 1

Referring to Table V, the firm's size (FSize) has a significant t-value at $\alpha = 5\%$. Thus, we conclude that the null hypothesis $H1_0$ is rejected and $H1_1$ is not rejected. In other words, the firm's size positively affects the firm's value.

2) Hypothesis 2

Referring to Table V, the firm's leverage (Lev) has a significant t-value at $\alpha = 5\%$. Thus, we conclude that the null hypothesis $H1_0$ is rejected and $H1_1$ is not rejected. In other words, the firm's leverage negatively affects the firm's value.

3) Hypothesis 3

Referring to Table V, the firm's gearing (Gear) has a significant t-value at $\alpha = 5\%$. Thus, we conclude that the null hypothesis $H1_0$ is rejected and $H1_1$ is not rejected. In other words, the firm's gearing negatively affects the firm's value.

4) Hypothesis 4

Referring to Table V, the firm's Market Capitalization (MCAp) has a significant t-value at $\alpha = 5\%$. Thus, we conclude that the null hypothesis $H1_0$ is rejected and $H1_1$ is not rejected. In other words, the firm's market capitalization positively affects the firm's value.

5) Hypothesis 5

Referring to Table V the firm's Profitability (Prof) has a significant t-value at $\alpha = 5\%$. Thus, we conclude that the null hypothesis $H1_0$ is rejected and $H1_1$ is not rejected. In other words, the firm's profitability positively affects the firm's value.

D. Implication for Research and Practice

This study includes both theoretical and practical implications. From a theoretical perspective, this study is expected to become a reference for further research on Firm's value and Corporate Governance in Lebanon. The findings support some earlier studies and contradict others, which opens opportunities for academic debates and further research on the subject area. Regarding the practical implications, the findings of this study are expected to provide information for concerned authorities to develop regulations that would increase the implementation of Corporate Governance in Beirut Stock Exchange. Moreover, the present study provides valuable input for regulators who

request continuous analytical work to know the implications of poor governance for firm transparency.

V. CONCLUSIONS, LIMITATIONS, AND FUTURE RESEARCH

The purpose of this study is to assess Corporate Governance proxies on firm's value of publicly listed firms in Beirut Stock Exchange for fiscal years 2014, 2015, and 2016. The independent variables used as proxies for Corporate Governance are firm size, leverage, gearing, market capitalization, and profitability. The firm's value is measured through Tobin's Q, which takes the market value of equity plus the book value of debt divided by the book value of total assets. Results of the analysis show that the firm's size, market capitalization, and profitability have a statistically



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positive effect on the firm's value, while leverage and gearing have a statistically negative effect. Therefore, some corporate governance practices would impact the firm's value either positively or negatively.

Similar to other empirical studies, this study has some limitations. However, apart from the limitations of the study, this research also stipulates the opportunity for future research. The limitations and the opportunity for further research associated with this study are as follows:

- The proxies of corporate governance used are only firm size, leverage, gearing, market capitalization, and profitability. Further research may include other proxies, such as corporate governance index, board independence, board size, ownership management, audit committee independence, frequency of audit committee meetings, chairman/CEO role duality, and ownership concentration.
- The study uses 2014, 2015, and 2016 data. Future research may use longer periods in examining the correlation between corporate governance proxies and the firm's financial performance.
- Generalizing the findings of this study may be questionable, since only publicly listed firms of Beirut Stock Exchange are used in this research. Hence, it is suggested to study other stock markets throughout the middle East to validate the outcome of a new model that may possibly be generalized.

Notwithstanding its limitations, this study appreciably contributes to the literature of corporate governance in several ways. First, it confirms as well as contradicts with findings of earlier studies. Second, and to the best knowledge of the researchers, this is the first study in Lebanon that examines the effect of corporate governance proxies on firm's financial performance. Finally, the choice of a large sample, representing 100% of the population of publicly listed firms in Beirut stock Exchange, contributed in incapacitating the restraints of former studies that used small samples as opposed to a population.

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