

## Does CEO Duality Enhance Firms Business Performance? Empirical Evidence from Bahrain

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### Abstract

*The purpose of this study is to examine the effect of CEO duality- as a member of board, chairman of the board on firms' performance measures such as ROA, ROE and Assets Turnover on the listed companies in Bahrain Bourse. Data sample are from 39 companies for three years 2010, 2011 and 2012. This study applied correlation and linear regression analysis. Correlations among the variables and regression models are not found to be significant at 5% level but CEO as a board member positively related with ROE and assets turnover but negatively related to ROA where as CEO as Chairman of the board is negatively related to all performance variables'. Regression analysis reveals CEO duality has no significant effect on firms' performance measures. This study contributes to the literature on the impact of CEO duality on firms' performance measures.*

**Keywords:** CEO duality, Business performance, Bahrain

### 1. Introduction

CEO is empowered to manage all resources of the organization using the powers bestowed on him by the board. CEOs typically mandated to oversee to optimize all resources such as money, time and human resources and liaison with board on behalf of the staff. In some organizations board offer CEO full membership in the board in addition to keeping the CEO in a managerial position, thus enabling him to play a role in governance, offering the voting rights—on the board. CEO who is on the board enjoys great privilege but must also play his role with a sense of great responsibility. CEO can enjoy more importance and influence among board members at par with other board members. CEO who is on the board must balance between the two roles, one managing day to day operations for which he is appointed and two playing decision making and governance role at the board. Some boards believe that the CEO should be on the board to help them understand their decisions; others think the CEO is bestowed with excessive power. CEO is the key person in ensuring corporate governance practices as laid down by regulators and recommended by the Board of directors. As CEO is the face of the corporation, it is imperative that he projects good image of the corporation to the world by ensuring good corporate governance mechanisms thus making all stakeholders proud of. CEO duality refers to a situation where a CEO also acts as a chairman of the board or a member of the board that governs the corporation.

When CEO is also chairman of the board, responsibility for chairing the board of director meetings lies with the CEO, which may held multiple times per year or as stipulated by corporate governance code of the country the corporation registered. CEO as Chairman is also responsible for setting agendas that will be discussed among the board members, reviewing the minutes and ratifying the same in the Board. CEO is authorized to do the processes of recruiting, retrenching, terminating and compensating top management. Some of the researchers' agree that the CEO increases the decision making power if he is acting as a chairman of the board too, but decisions made may be pro management but not in the interest of shareholders. When CEO, as the top manager of the corporation, responsible for channelizing resources to achieve companies strategic goals that are set by the board, but chaired by CEO is expected to improve company's performance due to dual leadership. Nevertheless, some others have another opinion that separating CEO and chairman could reduce the bankruptcy risk and increase the chances of raising capital. Thus this research focus on the effect of CEO duality on firms' performance ratios Return on Assets, Return on Equity and Assets turnover on firms registered with Bahrain Bourse.

### 2. Literature Review

Some Researchers agreed that the CEO increases the decision making power if he is acting as a chairman of the board. CEO duality an unambiguous leadership may help in enhancing company performance as a consequence.

Nevertheless, some other have another perception that separating CEO and chairman sends positive signals to corporate lenders, hence increases the chances of raising additional capital that reduces the risk of bankruptcy. Yermack (1996) reported that “firms are more valuable when the CEO and chairperson's positions are held separately”. Fosberg (2004) opined that “Firms where the position of CEO and chairperson are clearly separated are likely to employ the optimal amount of debt in their capital structure”. According to Ehikioya & Benjami (2009) firms in which CEO and Chairman of the board are separated stakeholders are likely to gain confidence on the firms' ability to raise additional capital and hence there are less chances of bankruptcy of the firm. Research carried out by Coles J.W., McWilliams, V.B. & Sen N. (2001) suggests that CEO as a chair may impede the board from their duties and responsibilities including assessing and monitoring performance of the management. Such a corporate scenario would create agency costs resulting in ineffective board and reducing overall performance of the corporation. Core, J.E., Holthausen, R.W. & Larcker, (1999) found that CEO duality leads to weak governance structures.

Agency theorists suggests that when a board chairman is also a CEO, “will gain sufficient controlling power to gain more private benefits” (Finkelstein & D'Aveni, 1994). Abdulla (2004) posited that “the firm's managers' ability to determine the board agenda and the flow of information is predicted to be much stronger when the board chairman is also CEO than when the firm adopts a non-dual structure”. Brickley et al., (1997) advocated that when the CEO and chairman posts are separated has both costs and benefits, and it is more of a cost to the larger firms than the benefits. Dorata, N.T, & Petra, S.T (2008) who conducted study on firms based on size and complexity pointed out that “CEO duality may be necessary due to firm complexity and firm performance is negatively associated with compensation that is beyond what is expected from economic determinants, such as size and performance”.

### **3. Research Hypotheses**

This research focus on influence of CEO duality on firms' performance measures such as Return on assets, return on Equity and asset turnover ratio. Proposed hypothesis are

H1: CEO as Board of Director is significant to firms' performance.

H2: CEO as Chairman of the Board is significant to firms' performance.

### **4. Sample Data, Research Method and analysis**

The data for this research had been collected from the companies listed in Bahrain bourse. Of 49 listed companies data are taken from 39 companies as 10 companies had insufficient data and hence not included in this research. Data collected for the variables CEOBOD-CEO is also a Board Member, CEOCHAIR –CEO is also a Chairman of the board as independent variables and Return on assets, return on Equity and asset turnover ratios as dependent variables. If the firm has CEO as BOD, CEO as Chairman of the Board, value 1 otherwise 0 was awarded. The data was collected from Investors Guide published by Bahrain bourse for the years 2010, 2011 and 2012. This research has utilized  $39 \times 3 \times 5 = 585$  data points. Statistical technique ordinary least square regression analysis has been employed to test hypothesis statements at 5% level of significance.

From table 1 Return on equity for three years has an average return of 4.20% whereas return on assets has an average return of 5.21% for the three years. Around 22% of the firms has CEO on their boards as member whereas firms with CEO as Chair is insignificantly very low at 0.9%. But assets turnover is sufficiently stays at 31.15%. It could be observed CEO duality does has some negative relationship with ROE, ROA and Assets turnover.

From table 2 CEO being a member of board is positively correlated with ROE and Assets turnover but negatively associated with ROA though these values are having low correlations not significant at 5% level. CEO as Chairman of the board is negatively lowly correlated with all the three variables ROE, ROA and Assets turnover and not significant at 5% level.

**Table 1 Descriptive Statistics**

|                    | Minimum | Maximum | Mean   | Std. Deviation |
|--------------------|---------|---------|--------|----------------|
| ROE                | -300.03 | 27.79   | 4.2037 | 31.16957       |
| ROA                | -34.26  | 111.55  | 5.2056 | 12.25761       |
| CEOBOD             | .00     | 1.00    | .2222  | .41753         |
| CEOCHR             | .00     | 1.00    | .0085  | .09245         |
| ASSETS<br>TURNOVER | -7.48   | 1.51    | .3115  | .79494         |

**Table 2 Pearson Bivariate correlation Analysis (significance values)**

|                    | ROE | ROA   | CEOBOD       | CEOCHAIR     | ASSETS<br>TURNOVER |
|--------------------|-----|-------|--------------|--------------|--------------------|
| ROE                | 1   | 0.447 | 0.029(.754)  | -0.037(.692) | 0.093(.320)        |
| ROA                |     | 1     | -0.150(.107) | -0.052(.577) | 0.105(.258)        |
| CEOBOD             |     |       | 1            | 0.1740(.061) | 0.120(.197)        |
| CEOCHAIR           |     |       |              | 1            | -0.028(.762)       |
| ASSETS<br>TURNOVER |     |       |              |              | 1                  |

**4.1. Regression Model 1**

$$\text{ROE} = \text{Constant} + \beta * \text{CEOBOD}$$

$$\text{ROE} = 3.72(\text{sig}.259) + 2.19(\text{sig}.754) * \text{CEOBOD}$$

$R^2=0.001$   $F=0.099$  ANOVA's test  $\text{sig}=.754$ . The model and coefficient of the variable CEOBOD is not statistically significant at 5% level. The variable has very low explanatory effect on ROE. But CEO as a member of the board contributes positively to ROE.

**4.2. Regression Model 2**

$$\text{ROE} = \text{Constant} + \beta * \text{CEOCHAIR}$$

$$\text{ROE} = 4.31(\text{sig}.0.141) - 12.480(\text{sig}.0.692) * \text{CEOCHAIR}$$

$R^2=0.001$   $F=0.158$  ANOVA's test  $\text{sig}=0.692$ . The model and coefficient of the variable CEOCHAIR is not statistically significant at 5% level. The variable has very low explanatory effect on ROE. But CEO as chairman of the board contributes negatively to ROE.

**4.3. Regression Model 3**

$$\text{ROA} = \text{Constant} + \beta * \text{CEOBOD}$$

$$\text{ROA} = 6.184(\text{sig}.000) - 4.401(\text{sig}.0.107) * \text{CEOBOD}$$

$R^2=0.022$   $F=2.644$  ANOVA's test  $\text{sig}=0.107$ . The model and coefficient of the variable CEOBOD is not statistically significant at 5% level but narrowly significant at 10% level. The variable has only 2.2% explanatory effects on ROA. But CEO as a member of the board contributes negatively to ROA.

**4.4. Regression Model 4**

$$\text{ROA} = \text{Constant} + \beta * \text{CEOCHAIR}$$

$$\text{ROA} = 5.625(\text{sig}.0.000) - 6.905(\text{sig}.0.577) * \text{CEOCHAIR}$$

$R^2=0.003$   $F=0.313$  ANOVA's test  $\text{sig}0.577$ . The model and coefficient of the variable CEOCHAIR is not statistically significant at 5% level. The variable has very low 0.3% explanatory effect on ROA. But CEO as chairman of the board contributes negatively to ROA.

#### 4.5. Regression Model 5

$$\text{Assets Turnover} = \text{Constant} + \beta * \text{CEOBOD}$$

$$\text{Assets Turnover} = 0.261(\text{sig}0.002) + 0.229(\text{sig}0.197) * \text{CEOBOD}$$

$R^2=0.014$   $F=1.682$  ANOVA's test  $\text{sig}=0.197$ . The model and coefficient of the variable CEOBOD is not statistically significant at 5% level. The variable has very low 1.4% explanatory effect on Assets Turnover. But CEO as a member of the board contributes positively to Asset turnover.

#### 4.6. Regression Model 6

$$\text{Assets Turnover} = \text{Constant} + \beta * \text{CEOCHAIR}$$

$$\text{Assets Turnover} = 0.314(\text{sig}0.000) - 0.244(\text{sig}0.762) * \text{CEOCHAIR}$$

$R^2=0.001$   $F=0.092$  ANOVA's test  $\text{sig}=0.762$ . The model and coefficient of the variable CEOCHAIR is not statistically significant at 5% level. The variable has very low explanatory effect on Assets Turnover. But CEO as the chairman of the board contributes negatively to Asset turnover.

Therefore the hypothesis are rejected at 5% level of significance as all p values are greater than 0.05. CEO duality is not statistically significant to firm's business performance.

### 5. Conclusions and Recommendations

Though the hypothesis are rejected, it is observed that when CEO as a member of the board has positive effect on ROE and Assets turn over than when CEO as Chairman of the board. It may be attributed to the fact that as employee stock holder in the corporation his actions are channelized towards equity shareholders. In general CEO duality, affects business performance as measured by ROE, ROA and Assets turnover ratio negatively. This result is in alignment with Pi, L., Timme, A., (1993) who found negative relationship between CEO duality and accounting performance measures. More such a research is encouraged as the corporate governance code that's implemented is of just three years old and takes substantial time in evolving good corporate governance system.

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