
The Impact of Firm's Level Corporate Governance on Market Capitalization

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Abstract: The examination of the influence of firm's level CG on market capitalization is potentially important for managers to improve CG system in context of Bangladesh. The linear relationship between CG and market capitalization is recognized at one percent level of significance. A positive and significant relationship between board independence and market capitalization is identified. On the other hand, a negative and significant relationship between public ownership and market capitalization is detected by the model. The present practice of CG does not capable to bring back the eroded confidence of external shareholders. The study recommend some steps for improve the situation such as at least two independent directors or one-third whichever is higher, mandatory training for directors to improve their mindset, introduce audit review system, introduce VFM review mechanism, establishing a high powered financial reporting council (FRC) and so on.

Keywords: Corporate Governance, Market Capitalization, Board Independence, Family Ownership, Capital Market

1. Introduction

The central bank of Bangladesh categorizes the financial system into three sectors on the basis of degree of regulation. They are formal sector, semi-formal sector and informal sector. The formal sector includes all regulated institutions like banks, non-bank financial institutions, insurance companies, capital market intermediaries (like brokerage houses, merchant banks etc.) and micro-finance institutions. The semi formal sector includes those institutions which are regulated otherwise but do not fall under the jurisdiction of central bank, insurance authority, Securities and Exchange Commission (SEC) or any other enacted financial regulator. This sector is mainly represented by specialized financial institutions like house building finance corporation (HBFC), palli karma sahayak foundation (PKSF), samabay bank, grameen bank etc. non government organization (NGOs) and discrete government programs. The informal sector includes private intermediaries which are completely unregulated. Financial market could be segregated primarily into short-term (Money market) and long-term (Capital market); long-term market is segregated into security segment (share, debenture, preference share, bond etc.) and non-security segment (long-term bank loan); and security segment is segregated into primary (IPO) and secondary market (Stock market). The market mechanism for

the buying and selling of new issues of securities is known as primary market. In this process, the company issues their share to the people directly by following necessary formalities with the regulator. The secondary market, also called stock exchange, on the other hand, deals with securities that have already been issued for trading. In this case, transactions of shares are made between old investors (seller) and new investors (purchaser) in the stock exchange through stockbrokers where beneficiary owners (BO) accounts are maintained. The companies need two type of financing based on time reference such as short-term and long-term financing to operate the business. Money market is used for short-term financing (working capital) and primary market is used for long-term financing (long-term investment such as machinery purchase, extension of building etc.). When we talk about the capital market we usually mean secondary market or stock exchange where a lot of shares of different companies are traded every working day. The flow of money in the stock exchange does not flow to the company but it provides liquidity support for the shareholders of the company. Formation of capital through savings and investments is necessary precondition for development of an economy and capital market has an important role in this process. The various indicators of stock market are used to guess the status of a country economy. Market capitalization is one of the important stock market indicators. The up-down of market

capitalization depends on the movement of investors. Generally, the movement of investors towards a particular company depends on the positive information of that company and vice-versa. Corporate governance (CG) mechanism provides assurance to investors and the degree of assurance depends upon the level of practices of CG in the firm.

The high number and high value of corporate scandals during the first years of the 21st century have had a dramatic effect on CG (Marlene and John, 2011). It refers to the structures and processes for the direction and control of companies. Good CG has a contribution to sustainable economic development through enhancing the performance of corporate entities and increasing their access to outside capital. Sound CG enhances the level of investors' confidence in the firm's future cash-flows and growth prospects (Haque et al., 2013). The present scenario of CG is far below the expected level in Bangladesh (Hasan et al., 2014c). CG practices are gradually being introduced in most companies and organizations. 66.7 percent companies have adopted CG and 43 percent have compliance policy with national or international benchmarks. A considerable percentage of the top management does not fully understand the concept of CG (Du, 2006). Bangladesh has lagged behind its neighbors and the global economy in CG (Gillibrand, 2004). Greater independence and professionalism is required in the boardrooms of both listed companies and state-owned enterprises (World Bank, 2009). Moreover, there is hardly any pressure group for enforcing CG principles.

In addition, the corporate sector depends on bank loan as their major source of financing. Capital market is in the embryonic stage as market capitalization amounting to only 6.5 percent of GDP with low investor confidence on CG and financial disclosure practices in many publicly traded companies (Du, 2006). Awareness of the importance of CG is growing very slowly. As such the largest financial market repeatedly faces challenges with great fall down of share price and a large portion of liquid money just go missing from the market in a single moment. Up and down is the common feature of capital market but there must have certain consistency and level of protection which is missing in Bangladesh (Hoque and Nasrin, 2013). The overall performance of stock market shows low trading volume, intermittent bumps, not many new offerings, unsteady valuations more on the declining side than otherwise (Hossain, 2005). In 2009-2010 the number of participants dramatically increased in the stock market and hence market capitalization. The market capitalization to GDP ratio is over 20 percent (The Daily Star, July 19, 2009). But the stock market crash in 2011, which is the largest crash in the corporate history of Bangladesh, has seriously eroded investors' confidence. The overall framework for investors' protection and CG has a number of important weaknesses that have delayed the capital market development (Khan, 2007).

CG practices matter because it allows firms to have greater access to financing, reduces the cost of capital, ensures higher valuation of the firm and allows for better operational performance (Claessens and Yurtoglu, 2012). According to

Capiro and Levine (2002), CG influences the efficiency of a firm's production at the firm level so that the effectiveness of a nation's CG system shapes economic performance at the country level. A best-practice approach encompasses other stakeholders not merely the shareholders and the directors (Marlene and John, 2011). With better investor protection and lower expropriation by controlling shareholders, outsider investors intend to invest more or pay higher share prices in the hope that more of the firm's profits would come back to them as interest or dividends (La Porta et al., 2002). Claessens (2003) identifies several channels, through which CG frameworks influence the growth and development of economies, financial markets and firms. These include, greater access to financing, lower cost of capital, better firm performance, reducing risks of financial distress and financial crisis, and more favorable treatment of all stakeholders. When firms stick to sound CG practices, they are able to balance multiple stakeholders' interests, meet both legal obligations and general societal expectations. Since good CG practices enhance transparency and accountability in companies, investors are better placed to make informed investment decisions. Shleifer and Vishny (1997) observe that a firm is likely to get external finance due to assurances provided by the CG system.

Therefore, we argue that firms' level CG practices might have an impact on market capitalization. As of today, the previous researchers focus on the relationship between CG and firm's performance and they measure firm's performance in various ways such as return on equity, return on capital employed, Tobin-q equation etc. However, the past researchers did not focus on the impact of CG over market capitalization. Market capitalization is a dynamic measure of market value of the company. All sort of information either positive or negative of the company is adjusted in the share price immediately after release the information. A research gap exists and we strive to fill this research gap. The objective of this study is to examine the influence of firm's level CG on market capitalization. This study contributes a new insight of firm's level CG if we find a linear relationship with market capitalization. Management might be motivated to improve their level of CG practices to enhance their reputation in the capital market.

The next section presents literature review and this is followed by a description of the research method, the discussion of the findings, and the conclusion.

2. Literature Review

The previous researchers on CG focused on many issues like firm's performance, capital market development, compliance, regulations, financial reporting, etc. based on CG index, regulations, Tobin's q formula, overall disclosure index, voluntary disclosure etc. We carefully review the existing CG literature to identify the research gap. Sarkar (2007) examines the impact of shareholder protection on stock market developments as well as the impact of stock market developments on private fixed capital formation. In both cases, he finds non-existent of long-term relationship.

He observes that law does not matter for stock market development. He used CBR index based on the book law—not the actual implementation. There is a view that the rule of law is at a very miserable stage in many LDCs including India because of corruption and other imperfections. Haque et al., (2008) outline a conceptual framework of the relationship between CG and two important elements of capital market development namely, a firm's access to finance, and its financial performance. The framework assumes that a firm's CG is concurrently determined by a group of connected governance components and other firm characteristics. Whereas the capital markets play a crucial role in augmenting CG standards, the effectiveness and genuineness of such effort might be embarrassed by poor firm-level CG. Moreover, the cause and effect relationship can work in the reverse direction for instance firm-level CG quality can augment both the firm's ability to gain access to finance and its financial performance, which ultimately lead to capital market development. Santner and Villalonga (2010) exploit an exogenous shock to corporate ownership structures created by a recent tax reform in Germany to explore the link between CG and internal capital markets. They find that firms with more concentrated ownership are less diversified and have more efficient internal capital markets. Their findings provide direct evidence in support of Scharfstein and Stein's (2000) model, which recommends that internal capital misallocations are partially an outcome of poor CG. Ariadna (2010) analyzes the affects of CG on the performance of financial markets. He models the interaction between a firm's manager and its shareholders, and highlights the role played by the dividend report in information disclosure and information communication. The researcher uses three channels such as the dividend willingly paid; the profits held by shareholders in case of interference; and the price set by the market maker. The result shows that CG affects market liquidity: higher monitoring costs, lower ownership concentration, effective disclosure regulation and effective shareholder protection, all lead to higher market liquidity. Balasubramanian et al. (2010) contribute to the literature on CG indices and the connection between governance and firm value. They form a broad Indian CG Index (*ICGI*) and examine the association between *ICGI* and firm market value. *ICGI* Index consists of five groups namely, board structure, disclosure, related party transactions, shareholders' rights and board procedure. They rely on the survey and firm annual reports to create an India CG Index (*ICGI*). They use "Tobin's *q*" as principal measure of market value. They find a positive and statistically significant association between *ICGI* and firm market value in India but sub-indices for board structure, disclosure, board procedure, and related party transactions are not significant. The non-results for board structure contrast to other recent studies, and suggest that India's legal requirements are sufficiently rigid so that over compliance does not produce valuation gains. Anglin and Gao (2011) examine how changes in CG regulations, especially those related to disclosure, affect the market process. With many sources of information, a policy

designed to improve information quality should combine the obvious direct effect with indirect effects, some of which are not usually considered. They display that the effects on total information quality depend on the relations between public reports and the information obtained by private investor. Therefore, governance reforms can touch the level of private information by affecting the behavior of private investors and, indirectly, the market maker. Kowalewski (2012) investigates the association between CG, measured by CG Index (*CGI*), and firm's performance and dividend payouts during the financial crisis in Poland. The results show a positive association between CG and performance measured by "Tobin's *q*". Moreover, he finds evidence that higher CG leads to an increase in cash dividends. Finally, the results presents that during the recent financial crisis CG is definitely associated with return on assets. However, in the period of the financial crisis better governed companies pay dividends less generously than do firms with lower CG standards. Claessens and Yurtoglu (2012) study current research on CG, with an exceptional focus on developing markets. They find that improved corporate outlines help firms through greater access to financing, lower cost of capital, better performance, and more favorable treatment of all stakeholders. The paper concludes by identifying issues requiring further study, including the special CG issues of banks, and family-owned and state-owned firms, and the nature and elements of public and private enforcement.

We also review the past researchers works on CG in Bangladesh. Rashid et al. (2007) explore an overview of CG in Bangladesh. They identify six specific CG characteristics in relation to current CG practices in Bangladesh namely legal and regulatory frame work, weak institutional control, predominance of individual investors, limited transparency & weak disclosure practices etc. Andres and Vallelado (2008) examine the role of the board of directors while applying CG in banking business. They point out that board composition and size are related to directors' ability to monitor and advice management and that larger and not excessively independent board might prove more efficient in monitoring and advising functions, and create more value. Kha et al. (2009) critically review the legal systems and CG guidelines issued by SEC. To reduce conflict of interest between shareholders (Principal) and management (Agent), it is necessary to have strong CG practices which can be monitored by capital market regulators. This study is a descriptive one. Karim et al. (2010) investigate the extent to which listed companies comply with the CG guidelines of SEC. They survey annual report for the period of 2007 of 51 companies. The mean disclosure is 85.5 percent compliance. However, the practical CG compliance test is much more important as most of the companies tick the comply column under 'comply or explain' format of CG reporting whereas the financial reporting of companies suffers the lack of qualitative characteristics. Rashid et al. (2010) examine board composition and firm performance from Bangladesh perspective. The study also tests the influence of corporate board composition in the form of representation of outside independent directors on firms'

economic performance. The finding of the study provides an insight to the regulators in this pursuit for harmonization of internal CG practices. Kutubi (2011) examine the impact of board size and the independent directors on the performance of the local private commercial banks. The study reveals that statistically significance positive relationship existed between the proportions of the independent directors and the performance of the banks. Hossain (2011) underlines the CG practices pointing out that good CG has implication for company behavior towards employees, shareholders, customers & bankers. He suggests that improved CG can provide noteworthy rewards to both individual companies and countries. Huq and Bhuiyan (2012) examine 10 specific problems through survey of an open ended questionnaire by selecting 24 respondents out of 66 personnels from 6 selected banks. They survey annual report to examine the organogram of both Islamic and Conventional banks. One of the ten specific problems is the weak role of the capital market. Bangladesh does not have depth in its equity market. All respondents point out that the Bangladesh capital market is still weak in its journey towards strengthening CG. Meah (2013) examine some definitions, principles, concepts and legal framework of CG. The study also investigate the extent to which the capital market comply with the CG guidelines of Bangladesh Securities and Exchange Commission (BSEC) and he also indicates that only sound CG practices are the foundation upon which the confidence of investors is originated. However, the CG guidelines issued by BSEC is only applicable for the listed companies of capital market and not applicable for capital market. Hasan et al. (2013b) examine the relationship between corporate governance and disclosures. They find a linear relationship between corporate governance and disclosures. External auditor, a corporate governance variable, can significantly influence the level of

corporate financial disclosures. Hasan et al. (2014c) study family performance and corporate governance structures. They find weak practices of corporate governance comparing with CG guidelines. Hasan et al. (2014b) examine the linear relationship between corporate governance and corporate accruals (discretionary accruals). They find that corporate accrual does not depend upon the corporate governance rather it comes from the mindset of management.

Although there is an extensive body of research on CG and capital market development, less attention has been paid on the issue of impact of degree of assurance (firm level CG) on market capitalization. This paper attempts to bridge this gap testing empirically five research hypotheses relating to firm's level CG and market capitalization. The findings of this study would motivate corporate managers to introduce best practice of standard in the firm for sustainable development e.g., corporate responsibility and corporate citizenship.

3. The Variables and Hypotheses

We select some variables in order to test the linear relationship between CG and market capitalization (*MC*). The market values of equity of sampled companies (*MC*) is used as a dependent variable while Board Independence (*BI*), Dominant Personality (*DP*), Board Size (*BS*), Public Ownership (*PO*), and Family Ownership (*FO*), are used as independent variables and Institutional Ownership (*IO*) and AGM Expenses (*AE*), are used as control variable in this study.

The definition and measurement of the variables included in the model and the range of their values are presented in Table 1. We will now briefly review the CG literature about independent variables to see what it states about their role in governance practices.

Table 1. The definition, measurement and range of values of variables.

Variables	Definition	Measurement	Range of Values	
Dependent Variable				
Market Capitalization (<i>MC</i>)	Market value of equity of the sampled companies.	Closing share price multiplied by outstanding number of ordinary shares.	Any value	positive
Independent Variables				
Board Independence (<i>BI</i>)	Board independence is defined as the proportion of independent directors in the board.	Number of independent non-executive directors divided by total number of directors on the board	0 - 1	
Family ownership (<i>FO</i>)	Sponsor shareholders i.e., Family ownership	Code "1" for majority of share held by family members and "0" otherwise.	0, 1	
Public Ownership (<i>PO</i>)	Public ownership is defined as the ratio of shares held by general people in the ownership structure of sample companies.	Total number of shares held by general people divided by total number of issued shares	0 - 1	
Dominant Personality (<i>DP</i>)	Dominant personality is defined as the position of Chairman and CEO of sample companies are the same person.	Code "1" if Chairman also holds the position of CEO and "0" otherwise	0, 1	
Board Size (<i>BS</i>)	Board size is defined as total number of directors in the board of sample companies.	Number of the board of directors.	≤ 20	
Control Variables				
Institutional Ownership (<i>IO</i>)	Institutional ownership is defined as the ratio of institutional holdings in the ownership structure of sample companies.	Total number of shares held by institutions divided by total number of issued shares or "0" otherwise	0 - 1	
AGM Expenses (<i>AE</i>)	Annual general meeting expenses of the sampled companies.	Actual expenses of annual general meeting expenses that are shown in the annual reports of sampled companies.	Any value	positive

3.1. Board Independence

The first step of good CG system is board independence. Following the Anglo-American model, Bangladeshi companies conform to the unitary board structure (one-tier system), where the board is the highest governing body in the company. As the board is at the apex of internal control system, the role of outside independent directors becomes crucial in monitoring the performance of management. The board which comprises a number of independent directors has a greater monitoring and controlling ability over management (Fama and Jensen, 1983). The Cadbury report (1992) define 'independent' as being free from any business or financial connection with the company other than their fees or shareholdings. According to CG guidelines for listed companies in Bangladesh, "one-fifth of the total number of the company's board of directors, subject to a minimum of one, should be independent directors". While according to the listing requirement (Chapter 15 Section 02 Subsection1) of Malaysia, "A listed issuer must ensure that at least 2 directors or 1/3 of the board of directors of a listed issuer, whichever is the higher, are independent directors." As per this condition, if a company has only three board members, two of them are required to be independent (Malaysia, 2006). Board independence seeks fairness in the strategic decisions taken by the Board and effective monitoring of the decisions and activities of managers, thus ensuring transparency of information and proper image on the outside of organizations (Chen and Jaggi, 2000; Patelli and Prencipe, 2007). The agency theory supports the idea that to increase the board's independence from management, boards should be dominated by outside directors (Abdul Rahman and Salim, 2010). The following hypothesis is taken to examine the linear relationship between board independence and market capitalization.

H₁: There is a significant association between board independence and market capitalization.

3.2. Board Size

The number of directors in the boardroom may affect the monitoring ability of the board. A larger board size may bring a greater number of directors with experience (Xie et al., 2001) that may represent a multitude of values (Halme and Huse, 1997) on the board. Larger boards are often believed to be more capable of monitoring the actions of top management, because it is more difficult for CEOs to dominate larger boards (Zahra and Pearce, 1989). Similarly, Singh and Harianto (1989) suggest that larger boards can make it more difficult for the CEO to obtain consensus for taking actions that will harm shareholders' interests. In contrast, smaller boards may be more effective because they might be able to make timely strategic decisions (Goodstein et al., 1994). Fiegner and Brown (2000) find that smaller board size along with outsider representation is conducive to an active board with high level of involvement in strategic formulation. A reduced number of directors imply a high

degree of coordination and communication between them and managers (Jensen, 1993). Chaganti et al. (1985) claim that smaller boards are manageable and more often play a role as a controlling function whereas larger boards may not be able to function effectively as the board leaves the management relatively free. CG guidelines of Bangladesh provide that the number of the board members of the company should not be less than 5 (five) and more than 20 (twenty). The following hypothesis is taken to examine the linear relationship between board size and market capitalization.

H₂: There is a significant association between board size and market capitalization.

3.3. The CEO-Chairman (Dominant Personality)

The board exists to keep management accountable for the vast discretionary power it wields. Thus, when the chairman of the board is also the CEO, it makes management accountable to a body led by management. It can mean that the CEO is put in the position of evaluating his own performance. A 1992 survey of company directors by Korn/Ferry find that just below than 20 percent believe that separating the CEO and chairman positions will have a "very negative impact" on boardroom performance. A little more than 20 percent think it will have a "very positive impact" and not quite 60 percent think the impact of separating the roles will be neutral. Those who are in favour of separating the roles believe it will lead to more objective evaluation of the CEO and create an environment of greater accountability. When the CEO is also the chairman there is "too great temptation to 'tilt' things toward protecting CEO career interests" commented by one outsiders director in the survey (Monks and Minow, 2010). Rechner and Dalton (1991) find that companies with separate CEOs and chairman consistently outperform those companies that combine the roles. The CG literature has emphasized the need to separate the position of CEO (chief executive officer) and board chairman to guarantee the board independence and improve transparency (Jensen, 1993). Dechow et al. (1996) reveal that the duality CEO-chairman increases the likelihood of violating the accounting principles in American firms. Byard and Weintrop (2006) indicate that the presence of a CEO who serves also as the board chairman is associated with poor quality of financial information. Similarly, Beekes et al. (2004) and Firth et al. (2007) report that the financial reporting is more relevant in the case of separating the positions of CEO and board chairman for British and Chinese firms. Nevertheless, other authors do not detect a significant association between CEO duality and financial reporting (Ahmed et al., 2006; Bradbury et al., 2006; Petra, 2007). The following hypothesis is taken to examine the linear relationship between dominant personality and market capitalization.

H₃: There is a significant association between dominant personality and market capitalization.

3.4. Family Ownership

Family – owned business are found to be common in continental Europe, Latin America and Asia. It is estimated that over two-thirds of worldwide firms are owned and managed by families (Gersick et al., 1997). Schulze et al. (2003) find that family firms make up 80 percent of organizations in the U.S. In Chile, it is estimated that 75 percent of all firms and 65 percent of medium to large firms are families (Martinez, 1994) and in Germany, family companies comprise 80 percent of German Organizations (Reidel, 1994). A survey by the Bank of Italy illustrates that almost 80 percent family members are employees in the family companies (Corbetta, 1995). Likewise, average 85 percent of listed companies are family firms in Bangladesh, a family dominant country (Hasan et al., 2014c). Family firms are very much governed by family traits (Mishra et al., 2001). Families can combat the potential conflicts between families and firm, therefore, family firms may outperform their competitors, at least economically (Lee, 2004). Families are able to maintain the continuity of the family firms by transferring company assets over time. Thus, the market value of the firm can increase (James, 1999). Castilo and Wakefield (2006) find that family firms are uniquely suited to succeed over other publicly traded firms due to strong family ties. In addition, the extensive knowledge about a firm by the family members encourages quick and flexible decisions (James, 1999). In contrast, Barclay and Holderness (1989) note that large ownership stakes reduce the probability of bidding by other agents, thereby reducing the value of the firm. The family's role in selecting managers and directors creates an impediment to outsiders in capturing control of the firm, suggesting greater managerial entrenchment and lower firm values relative to non-family firms. Lauterbach and Vaninsky (1999) evidence that family firms run by their owners perform worse than the non-family firms. In Italy, Cuculelli and Micucci (2008) find that the negative impact of family companies' performance is exacerbated when company control is passed to the next family generation. The following hypothesis is taken to examine the linear relationship between family ownership and market capitalization.

H₄: There is an association between family ownership and market capitalization.

3.5. Public Ownership

Public ownership reflects the dispersion of ownership, which has a relationship with disclosure and transparency (Legenzova, 2008). Differences in the proportion of a firm that is owned by outsiders may account for some of the observed differences - in the comprehensiveness of mandatory disclosure, because the greater number of people who need to know about the affairs of a firm, the greater will be the details required of an item of information and the more comprehensive the disclosure of a firm will be (Apostolou et al., 2009). Leftwich et al. (1981) suggest that issuing financial reports can solve monitoring problems

associated with increases in the proportion of the firm owned by outsiders. It is expected that if a company has a large proportion of public ownership, the political cost will be bigger and the company will decide to disclose more information to satisfy them. Thomsen and Pedersen (2003) examine the relationship between owner identity and market valuation among the largest European companies. They differentiate owner identity into four types: family, financial institutions, government and companies. They find that the firm's largest owner of financial institutions and company have positive significant effect on firm value. The following hypothesis is taken to examine the linear relationship between public ownership and market capitalization.

H₅: There is a significant association between public ownership and market capitalization.

4. Research Framework

The research idea could be visualized by drawing a diagram to give a graphical view of diagnostic pattern of the problem under study. Figure 1 shows that board independence, board size, dominant personality, family ownership, and public ownership are used as firm's level corporate governance. Then, degree of influence of every step of firm's level corporate governance is estimated. The influence of board independence on market capitalization is estimated by testing the hypothesis 1 (H_1), the linear relationship between board size and market capitalization is estimated testing the hypothesis 2 (H_2), the association between dominant personality and market capitalization is estimated by testing of hypothesis 3 (H_3), the impact of family ownership on market capitalization is estimated by testing the hypothesis 4 (H_4), and the relationship between public ownership and market capitalization is examined testing the hypothesis 5 (H_5).

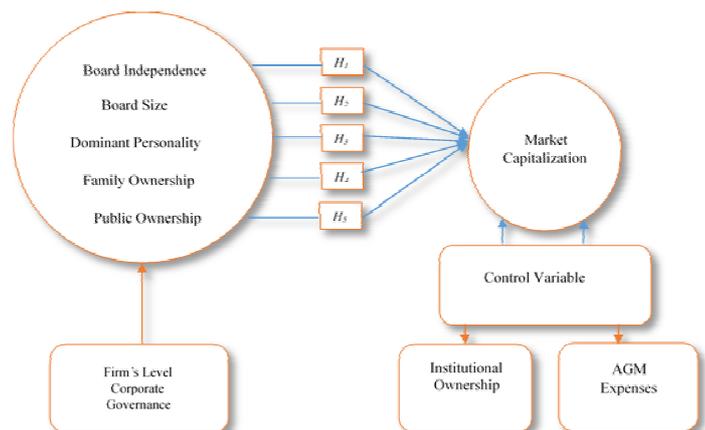


Figure 1. Research framework.

5. Data and Methods

5.1. Data

Of the 155 non-financial companies listed on the premier bourse, Dhaka Stock Exchange (DSE) in Bangladesh, 68 are

taken as a sample data set for the current study, based on access to their corporate annual reports for 2010-2011 (Table 5, Appendix 1). The sample size equates to 44 percent of the population so allows us to generalize the findings of this study. Market capitalization data are collected from DSE and the remaining data for all other variables are extracted from a survey of annual reports of sampled companies.

5.2. Methods

Descriptive statistics technique is used to form a central idea or overall situation of stock market and corporate governance as there is diversity in the level of market capitalization and CG practices across companies. Correlation matrix is used to analyze the multicollinearity between independent variables. It is essential to examine the multicollinearity between independent variables before going to use these variables in the multiple regression analysis. Because, if we find multicollinearity between two variables then one variable is needed to drop from the model as these two variables measure the same thing. If we do not want to drop the variable then we can go for second tier relationship by using second generation method - AMOS but it is not possible to build second tier relationship in SPSS. In SPSS, we must drop one variable if we find multicollinearity between two variables. A linear regression model is developed for in-depth analysis of the effect of assurance provider (firm level CG) on market capitalization. In other words, the model is used to estimate the effect of the relationship between *MC* and *BI*, *DP*, *BS*, *FO* and *PO*. We run the model in SPSS to see the adjusted R^2 , ANOVA and coefficients. The adjusted R^2 tells us about the fitness of the model, the p-value of ANOVA gives us an overall direction regarding accepting or rejecting the hypothesis and the p-values of coefficients tell us the significance level of the impact of the CG variables on market capitalization individually. The p-values of coefficients are used either accepting or rejecting the hypotheses. The acceptance criterion of hypothesis is at 1 percent or 5 percent level of significance. The model could be presented in the following form:

$$MC = \alpha + \beta_1 BI + \beta_2 BS + \beta_3 DP + \beta_4 FO + \beta_5 PO + \beta_6 IO + \beta_7 AE + \varepsilon$$

6. Results and Discussion

If we look at the results from the descriptive statistics, Table 2 shows that the average rate of board independence is 15 percent but as per CG guidelines the minimum rate of board independence is 20 percent meaning that the relationship of independent directors to board size is 1 (one) divided 5 (five) i.e., 20 percent ($= 1/5 \times 100$). Board independence is the primary element of CG. As per CG guidelines, one independent director is required against four board members for board independence. The ratio between board size and number of independent directors are not duly followed by many companies. Even some companies have

not yet appointed independent directors and some companies have ten board members but they have appointed only one independent director. But in Malaysia, if a company has only three board members, two of them are required to be independent (Malaysia, 2006). The average number, minimum number and maximum number of directors of the board are 8, 3 and 17 respectively. According to the CG guidelines, the minimum number of directors is 5 and maximum number is 20 members in the board. So, the condition of minimum number of directors in the board room does not fulfill the requirement by CG guidelines. Although, the board size is not enough for ensuring good governance but it is essential to create an environment where everybody will respect and follow the rules of CG guidelines. Besides, the academic qualification, professional experience, corporate integrity, ethical behavior, caring for others, and the like qualities of directors is utmost important to ensure good governance meaning that better companies means better society. Usually, members with these qualities in the board room are unexpected under family based CG. CEO-chairman (or CEO duality or dominant personality) is not allowed in the CG guidelines. The result shows that 26 percent of sampled companies are being operated by dominant personality. The CG guidelines stated that chairman and CEO position should be filled up by separate individual. The condition is not being fulfilled by some sampled companies. The rate is lower because these two positions have been fulfilled by separate individuals but our observation is to focus the relationship between two individual of these two positions for ensuring transparency, accountability and integrity. We see that sometimes wife is chairman and husband is CEO, sometime father is chairman and son is CEO, sometime elder brother is chairman and younger brother is CEO. So, the separation of control is not happening here in true sense. It is almost impossible to ensure good governance without separation of control. The concerned authority should look into the matter in such a positive way so that directors may come forward enthusiastically for their own sake. We also observe that some companies produce an excuse of financial burden and this is not acceptable at all for public limited companies. Therefore, the regulator as well as operators of stock market should take initiative to improve the CG scenario in the corporate sector in Bangladesh. Family ownership is the most influential component of ownership structure in Bangladesh. Table 1 reveals that 85 percent of the sampled companies have family ownership and hence most of the listed companies are one-man show. There is both side of argument on family ownership in the literature. For example, Fama & Jensen (1983 p.306) claims that "family ownership is particularly efficient to minimize agency problems because shares are in the hands of agents who have special relations with other decision agents that allow agency problems to be controlled without separation of the management and control decisions". However, family-companies can make sub-optimal decisions since the interests of the family are not necessarily consistent with

those of other shareholders (Fama and Jensen, 1985). Restricted ownership also reduces external governance and potential problems may arise when a firm is headed by a powerful owner / manager or family relationships tend to make agency problems more difficult to resolve (Schulze et al., 2001). The internal control system is usually poor in family firms and all sort of decisions are taken from personal perspective and power of authority is highly centralized. These organizations cannot offer good working environment for professionals as the chain of command is not maintained here and only toadies enjoy the job by flattering their boss. Moreover, the business entity concept of accounting does not allow the mixing between family and business. According to this concept, the entity is completely separate from the owner otherwise we cannot measure the accurate performance of the business. The average percentage of public ownership of in the ownership structure of the sampled companies is 41 percent. The result shows that a good number of individual participates in the capital market. This is spread ownership and they are considered as minority shareholders also called external shareholders. The companies publish annual report especially for them as they do not have access to the company accounts. Therefore, it is essential to provide reliable information in the annual report so that they can measure the performance of the company and take decisions accordingly. In the history of capital market in Bangladesh, two crashes had been occurred - one in 1996 and the other in 2010-2011. In 1996, the cause of crash was speculative bubble and in 2010-2011 the cause was asset pricing bubble. According to the inquiry report of 2011, accounting manipulation such as earnings manipulation, over valuation of assets in the name of revaluation, false reporting, payment of dividends from unrealized gain, non-compliance of accounting standards, non recognition of deferred tax implications on revaluation, poor quality of work of some audit firms etc., had been done to artificially increase share price. Besides, a section of directors of listed companies' especially family firms were involved in the manipulation of capital market. Therefore, shareholders do not have confident on the information published in the annual report. The users' perception about the qualitative characteristics of corporate financial reporting is far below the acceptable level and as such users' have a negative attitude towards disclosures of financial reporting (Hasan et al., 2014a).

Table 2. Descriptive Statistics.

Variables	N	Minimum	Maximum	Mean	Std. Deviation	CV
MC	68	71.45	267224.38	10067.54	33909.14	3.37
BI	68	0.00	1.00	0.15	0.14	0.96
BS	68	3.00	17.00	7.40	2.29	0.31
DP	68	0.00	1.00	0.26	0.44	1.71
FO	68	0.00	1.00	0.85	0.36	0.42
PO	68	0.05	0.94	0.41	0.22	0.53
IO	68	0.00	0.86	0.20	0.21	1.07
AE	53	36960	62161349	2975631	8742362	2.94

Table 3. Correlations Matrix.

Variables	BI	DP	BS	IO	PO	AE	FO
BI	1						
DP	-0.133	1					
BS	0.03	-0.061	1				
IO	0.153	-0.17	0.092	1			
PO	-0.127	0.083	-0.104	-0.410**	1		
AE	-0.027	-0.138	0.221	0.209	-.237*	1	
FO	-.380**	.249*	-.403**	-.358**	.403**	-.548**	1

Table 4. Results of regression test of the Model.

Predictors	Coefficients	T - Value	P - Value
BI	0.189	3.852	0.000**
BS	0.03	0.611	0.544
DP	-0.013	-0.293	0.771
FO	0.094	1.465	0.15
PO	-0.105	-2.156	0.036*
IO	-0.077	-1.57	0.124
AE	0.976	18.07	0.000**

R	0.958
R ²	0.918
Adjusted R ²	0.906
F Value	72.372
P Value	0.000*
DF Model	7
DF Error	45

Legend :	
BI	Board independence
BS	Board size
DP	Dominant personality
FO	Family ownership
PO	Public ownership
IO	Institutional ownership
AE	Annual general meeting expenses
R ²	The explanatory power of regression equation

If we look at the results from the correlation matrix, Table 3 shows that there is no multicollinearity issue between independent variables. The examination of multicollinearity between independent variables is necessary because if multicollinearity exists between two variables then one variable should be dropped from the model as these two variables measure the same thing. Judge et al. (1985) and Bryman and Cramer (1997) suggest that simple correlation is not harmful unless they exceed 0.80 or 0.90. The observed correlation between variables does not exceed 0.80 and therefore, the variables are not considered harmful in the interpretation of the results of the linear regression analysis.

Finally, if we look at the outcome from the regression model, Table 4 shows that the model is capable to explain 90 percent variation in market capitalization by the variation of CG variables and we also find a significant relationship between CG and market capitalization at one percent level of significance. So our research hypothesis is accepted. The table also shows that the board independence has a significant influence on market value of equity at one percent level of significance and public ownership has a linear correlation at five percent level of significance. Board size, family ownership and dominant personality do not have

significant influence on market value of equity or market capitalization. Therefore, hypothesis one and hypothesis five are accepted as they are supported by the results. Likewise, hypothesis two, three and four are rejected as they are not supported by the results of this study.

We find two important variables such as board independence and public ownership that have a significant association with market capitalization. Board independence is a necessary prerequisite for one of the board's most fundamental responsibilities – unbiased oversight of management (Abdul Rahman and Haniffa, 2005). There is a need of a board that is capable of taking strong independent action (and this means that a majority of directors should be truly independent) and also able to understand the company and its business. In other words, the board would be in a better position to achieve a better balance between independence and understanding of the business (Abdul Rahman and Salim, 2010). The composition of the board is a critical factor in establishing the effectiveness of the board as an objective monitor of management. The word “independent” has no universal definition and different countries have adopted different definitions of the word in their respective CG code. “Independent” is generally taken to mean that there is no relationship or circumstances which could affect the director's judgment. In order to be independent, a director must have no connection to the company other than sit on the board. Political motivation of independent director is also an important factor in context of Bangladesh. If chairman, CEO and independent director have the same political motivation then there is a possibility of using this network in the board room. If business leader have a motivation for independency of the board then it will have a positive image in the society which is very much useful for extending their business. The market value of the company will be higher and more business opportunity will come because an effective board can build trust in the society. It is disastrous for the marginal shareholders when directors themselves exercise opportunism (Hasan et al., 2014b).

Public ownership is also called spread ownership or external shareholders meaning that they do not have right to access to the company accounts. They are to rely on published annual reports for both information i.e., financial or non-information. According to the Companies Act 1994, the company will send their annual report to the address of shareholders before 14 days of annual general meeting (AGM). Shareholders can interact with the chairman of the board in the AGM if they need more explanation for the items in the annual report. It is alleged that most of the companies do not send their annual reports within the stipulated time. This misbehavior creates a negative impression about the corporate financial reporting among external users of annual reports. In a recent study we observe that 30 percent respondents opine that the financial statements is not prepared in an understandable manner, 81.05 percent respondents believe that corporate management is conservative while disclosing information, 44.21 percent respondents think that auditors do not perform

their duties with adequate competency, 54.74 percent respondents opine that existing financial reporting is not effective enough to protect the interest of shareholders, 58.42 percent of respondents believe that there is no possibility of good governance under family based culture and 91.58 percent respondents feel that establishing a monitoring cell is utmost important to oversee the reporting as well as auditing activities of the companies that can bring the trust on the annual reports (Hasan, 2013a). Moreover, earnings manipulation, improper revaluation of assets, non-recognition of deferred tax, non-compliance of accounting standards, inadequate disclosure, improper valuation of share price at the time of IPO etc. are mentioned in the probe committee report (2011). In addition to that, the committee also reports the name of some directors who are involved in manipulating of capital market and very influential in terms of money, industry, and political connections. This environment creates a negative attitude towards directors as well as auditors of the companies. The probe committee also recommends establishing a financial reporting council (FRC) to oversee the reporting and auditing activities of the companies.

7. Conclusion

This study concludes that firm's level CG has a linear relationship with market capitalization. We find a positive and significant linear relationship between board independence and market capitalization meaning that the more independency of the board, the more of the market capitalization i.e., market reputation in the stock market. This is positive result for ensuring good governance. On the other hand, we find a negative and significant relationship between public ownership and market capitalization meaning that public ownership is neither satisfied with the behavior of the reporting entity nor have trust of corporate reporting. This environment is not positive for good CG. We see the results of descriptive statistics and find the current practice of CG is in a very poor shape that needs to be addressed immediately for reinforcing confidence of the stakeholders in the capital market as well as in the society.

We recommend some mechanism that may help concerned stakeholders to find out a solution of the present problem such as introduction of audit review system, introduction of value for money review mechanism, establishing of high powered financial reporting council, ensure uniform corporate reporting of the companies in an industry, stopping the use of revaluation methods as if U.S. GAAP does not permit revaluation, opening awareness program of CG, mandatory for directors to participate in the training of CG, increase the number of independent directors at least 2 (two) or 1/3 (one-third) whichever is higher to ensure freedom in the board room, discourage unethical behavior of directors and auditors, introducing continuous professional education (CPD) for corporate executive and directors to change their negative attitude and develop their mindset for corporate good governance, the background of directors must be supported by

his / her education, professional experience, and personal traits, introduce an attractive as well as informative code of CG, introduce a group for inspecting physically the compliance of CG and stop the breathing space for them and the like. The limitation is small sample size although it is 44 percent but it would have been better if we took whole population as it is a small number i.e., 155 companies.

Appendix -1

Table 5. List of Sampled Companies

SN	Company Name	SN	Company Name
1	Rahim Textile	35	Ambee Pharma
2	Samorita Hospitals	36	Pama Oil Company
3	Savar Refractories Ltd	37	Salvo Chemical Industry Limited
4	Beach Hatechery ltd	38	British American Tobacco
5	Tallu Spinning Mills	39	Eastern Housing Limited
6	Imam Button	40	Bata Shoe Company
7	Safko Spinning	41	National Tea Company Limited
8	Anlima Yarn Dyeing Ltd	42	Aziz Pipe
9	Bangladesh Auto Cars Limited	43	Jamuna Oil Company Limited
10	Eastern Cables	44	National Polymer Industries Limited
11	Atlas Bangladesh Limited	45	Quasem Drycells Ltd
12	Meghna Petroleum Limited	46	CMC Kamal Textile Mills Limited
13	Apex Adelchi Footwear Limited	47	Bangladesh Lamps Ltd.
14	Deshbandhu Polymer Limited	48	Metro Spinning Mills Limited
15	Fine Foods Limited	49	MJL Bangladesh Limited
16	Khulna Power Company Limited	50	Aftab automobiles limited
17	GBB Power Limited	51	Square Textiles Limited
18	Libra Infusion Limited	52	Singer Bangladesh Limited
19	The Dacca Dyieng &b Manufacturing	53	ACI Formulations Limited
20	R. N. Spinning Limited	54	Prime Textile Spinning Mills Limited
21	BSRM Steels Limited	55	Saiham Textile Mills Limited
22	Bangladesh Thai Aluminium Ltd.	56	H. R. Textile Mills Limited
23	Keya cosmetics ltd	57	Agricultural Marketing Co Ltd
24	M I Cement Factory Ltd.	58	Apex Spinning & Knitting Mills Limited
25	Fuwang Foods Ltd.	59	Makson Spinning Mills Limited
26	Pharma Aids Limited	60	Malek Spinning Mills Ltd.
27	Kohinoor Chemical Company	61	Jute Spinners Limited
28	Samata Leather Complex Ltd	62	BD COM Limited
29	Sonali Aansh Industries Limited	63	Daffodil Computers Limited
30	Navana CNG Limited	64	United Airways Limited
31	Grameen Phone	65	Standard Ceramic Industries Limited
32	Dhaka Electric Supply Company Limited	66	Beacon Pharma
33	Titas Gas Transmission and Distribution	67	Orion Infusion Ltd.
34	Square Phrmaceuticals	68	Active Fine Chemicals Ltd

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