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Independence or In-dependence? Non-Strict Board Independence Among Publicly Listed Firms in the Philippines^{*}

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Abstract

Board independence is thought of as a corporate governance tool that mitigates agency conflicts among firms with either a widely held ownership structure or a highly concentrated ownership structure. As a result, having a high degree of board independence is adopted as the best corporate governance practice in most developed and emerging markets. However, owners of firms with less qualified or non-strict independent directors may not reap the benefits of board independence if such directors are appointed merely for the sake of satisfying quotas or stipulations for best practices. Thus, using data on Philippine publicly listed firms from 2012 to 2015, we construct a measure of non-strict board independence based on the 12 criteria for independence of the 2017 Philippine Corporate Governance Code and examine (1) what type of firm is more likely to appoint non-strict independent directors and (2) the effect of non-strict board independence on firm performance. Using panel data models, we find that firms with a higher ownership concentration are more likely to have non-strict independent directors on the board; however, the presence of these non-strict independent directors do not significantly impact firm performance among firms with high ownership concentration. Our findings support the optimal board independence theory, which posits that non-strict independent directors are appointed primarily to satisfy best corporate governance practices, even if such directors do not have outside expertise or monitoring ability. We conclude that while non-strict independent directors are present among Philippine publicly listed firms, they do not mask any agency problem for firms with large ownership concentration; rather, these directors may have been appointed for the firm to achieve its optimal level of board independence.

JEL Classification: G32, G30

Keywords: Corporate Finance, Corporate Ownership, Family Firms, Firm Ownership, Leverage, Ownership, Ownership Structure, Shareholder, Shares, Stockholder, Value of Firm

Introduction

Board independence is a central topic in the corporate governance literature. Its significance stems from its role as a corporate governance mechanism that mitigates agency conflicts found both in firms that are widely held and in firms with large controlling shareholdings. In widely held firms, agency problems manifest in the form of managerial opportunism, where managers take advantage of firm resources without enhancing firm value. On the other hand, in firms with large controlling shareholders, conflicts between majority and minority shareholders arise due to the expropriation of firm resources by the controlling shareholders. The presence of independent directors addresses both agency problems through their role of monitoring the actions of fellow board members and managers (Crespi-Cladera & Pascual-Fuster, 2014). While this view is widely accepted by the literature, the effectiveness of independent directors varies based on firm-level characteristics and the institutional environment in which these firms operate (Liu, Miletkov, Wei, & Yang, 2015).

The Philippines, as with many other countries in Asia, has a corporate governance environment characterized by the presence of corporate groups with large controlling shareholdings of some of the largest firms in the country. A significant portion of their leadership comes from the same business group, and this presents a situation wherein the largest owners, the board of directors, and the managers all have interests that are aligned but not necessarily with that of minority shareholders (Unite & Sullivan, 2000). The Philippines has a history of weak regulatory institutions unable to regulate their industries properly due to rampant corruption and poor governance (Unite & Sullivan, 2000); however, the country has been strengthening its corporate governance standards through reforms and various improvements.

The Philippine Securities and Exchange Commission (SEC) has been amending the corporate governance code every few years and has added disclosure requirements for publicly listed firms to improve transparency.¹ While the spirit of these amendments is to improve the corporate governance landscape of the Philippines, compliance may follow the statutory aspect of the code, but not necessarily the spirit of the code.

Mandates for a larger presence of independent directors on boards of publicly listed companies are common among corporate governance guidelines across countries of different institutional and business landscapes; however, in countries where the corporate sector is characterized by large business groups, independent directors may be appointed primarily to satisfy regulatory requirements. Ideally, an independent director provides advice to fellow board members and managers based on his/her expertise while monitoring their actions to prevent any form of opportunism or expropriation. In firms where ownership is dispersed, the agency conflict is present between the owners and managers. On the other hand, in firms where ownership is concentrated and where the board, managers, and owners all come from the same controlling group, the conflict is between this group and the minority shareholders. Appointing independent directors to satisfy corporate governance guidelines may be indicative of a severe agency problem present among firms that behave as such.

However, it may also be the case that firms have already achieved some form of optimal or desired level of board independence and appointing more independent directors may only be detrimental to the performance of the firm. In this case, shareholders may appoint directors that

¹ Through SEC Memorandum Circular No. 5 Series of 2013, dated March 20, 2013, the SEC started requiring all listed companies to submit their Annual Corporate Governance Reports (ACGRs), which improved the transparency of firms with regards to corporate governance, affiliations, and so forth (Securities and Exchange Commission, 2013). A more detailed discussion on board independence and its evolution in the Philippine Code of Corporate Governance can be found in Section 2.2 and Appendix A.

are not strictly independent, whose presence does not necessarily mask some agency problem that decreases firm value.

This study examines the incidence of non-strict board independence and its effect on firm performance among publicly listed firms in the Philippines. We first investigate how ownership structure affects the incidence of non-strict board independence, then we analyze the effect of non-strict independence on firm performance through its presence in the board and board committees. The results of this study extend the literature that examines the quality of directors and provide an idea on corporate governance practices relating to board independence among publicly listed firms in the Philippines.

Related Literature, Theoretical Framework, and Hypotheses Development

Philippine Business Environment

The Philippine business environment is one marred by the perception of rampant corruption that results in weak and ineffective regulatory institutions (Unite & Sullivan, 2000). In a 2012 study of Philippine business groups, dela Rama (2012) surveyed business news and interviews officials of publicly listed companies and several government officials, and found that corruption in the Philippines manifests in both petty and systematic forms of corruption, in line with the typology proposed by Rose-Ackerman (2008). In environments with weak legal institutions and lack of shareholder protection, business groups are thought to be a good means of conducting business because they provide the business with the ability to insulate and sustain itself in uncertain settings (La Porta, Lopez-de-Silanes, & Shleifer, 1999).

In the Philippines, where the corporate sector is dominated by large business groups, it is no surprise that the presence of interlocking directorates and large controlling shareholdings are

common among publicly listed firms. In her study of interlocking directorates in the Philippines, Tan (1993) showed that large business groups are centered around a commercial bank that interlock with other companies in the same conglomerate. These conglomerates are so large that they span across several industries including mining, agriculture, banking, among others, and this degree of conglomeration allows these business groups to become effective lobbying institutions or entities used to acquire political favors (Tan, 1993). Moreover, Claessens, Djankov, and Lang (2000) investigated several East Asian countries and the degree of ownership concentration in these economies; they found that in the Philippines, the largest 10 families control over half of the corporate assets in 1998. The ownership structure of publicly listed firms in the Philippines is examined much more thoroughly by Unite and Sullivan (2000) and they found that on average, the top owner of a listed firm owns 37% of the company; the top five shareholders own 64% of the company; the top 10 shareholders own 73% of the company; and the top 20 shareholders own 79% of the company. They also found that domestic family business groups effectively control 75 of the 196 Philippine publicly listed firms in 1997 (Unite & Sullivan, 2000). In this study, we found that on average, the top shareholder owns 54.85% of the firm's outstanding shares for the period 2012 to 2015. These figures are staggering, and they provide us with an idea of the corporate governance landscape of the Philippines.

Board Independence Guidelines in the Philippine Code of Corporate Governance

The Philippines has been updating its code of corporate governance since its promulgation in 2002. The 2002 Code of Corporate Governance (2002) issued on April 5, 2002, by the SEC is applicable to all publicly listed companies and those companies subject to secondary licenses from the SEC, and it provides a foundation for regulations relating to

corporate governance in the Philippines. With regards to board independence, the 2002 Code mandated that publicly listed firms have at least two independent directors or at least 20% of the board be composed of independent directors, whichever is lesser. On the other hand, companies not covered by the Code were only encouraged to appoint independent board members (SEC Memorandum Circular No. 2 Series of 2002, 2002). On November 28, 2002, the SEC released additional guidelines on the definition, nomination, and election process of independent directors; these guidelines list specific criteria (List A.1 of Appendix A) that disqualify a director from being classified as independent (SEC Memorandum Circular No. 16 Series of 2002, 2002).

The 2002 Code of Corporate Governance was revised on June 29, 2009. In the revised Code, all covered companies were required to have at least two independent directors or such number of independent directors that constitute 20% of the board, whichever is lesser, but in no case must the number be fewer than two. In addition, the revised Code added two new criteria for board independence: (1) non-independent directors may not be directors of a company two years prior to being nominated and elected as independent directors, and (2) individuals who were appointed as members of any executive advisory board must be separated from the company at least one year prior to being nominated and elected as an independent director (SEC Memorandum Circular No. 6 Series of 2009, 2009). To enhance the effectiveness of independent directors and encourage the infusion of fresh ideas in the board, the SEC introduced rules related to term limits of independent directors in listed, public, and mutual fund companies (SEC Memorandum Circular No. 9 Series of 2011, 2011). The list can be found in List A.3 of Appendix A.

The most recent development in Philippine corporate governance is the introduction of a new Code of Corporate Governance for publicly listed companies that adopts the “comply or

explain” form of enforcement. This new code was promulgated on November 22, 2016, and was made effective starting January 1, 2017 (hereinafter referred to as the 2017 Code) (SEC Memorandum Circular No. 19 Series of 2016, 2016). It updates the proportion of the board of directors that must be independent of two or 20% to three or 30% of the board, whichever is higher. Moreover, it retains and improves several criteria of independence from past guidelines² and adds three new criteria: an independent director (1) must not be a securities broker-dealer or a registered issuer of securities, (2) must not be affiliated with a non-profit organization that received funding from the covered company, and (3) must not be interlocked with any executive board member sitting on the covered company (Securities and Exchange Commission, 2016).

From the 2002 Code to the 2017 Code, the standards set by the SEC for a director to be classified as an independent director in publicly listed companies have become much more stringent. Older independent director criteria were subsequently updated over several memoranda, and new criteria were introduced to improve the quality of independent directors in the Philippines. However, the improvement in the criteria that define an independent director does not necessarily correspond to compliance from those for which the corporate governance code is intended. Table A of Appendix A summarizes the criteria introduced in 2002, 2009, and 2011 that were adapted into the new 2017 Code of Corporate Governance for Publicly Listed Companies.

Guidelines for the establishment and composition of board committees have also evolved from the 2002 Code to the 2017 Code. These board committees are envisioned to support various board tasks including audit practices, risk management, and compensation and remuneration,

² Examples of improvements from the previous Code include limiting the cumulative number of years a director can serve as an independent director, limiting the number of companies in a business group where an individual can serve as an independent director, increasing the “cooling-off” period of regular directors before their nomination and election as independent directors, among others. The complete independence criteria list of the 2017 Code of Corporate Governance for Publicly Listed Companies can be found in List A.4 of Appendix A.

among others. The establishment of an audit committee has been recommended since the 2002 Code. The committee should be composed of at least three members, with at least one independent director, and with the chair being an independent director. Moreover, at least one member should have audit experience. In the 2009 Code, it was recommended that the committee members have backgrounds in finance and accounting instead (SEC Memorandum Circular No. 6 Series of 2009, 2009). In the 2017 Code for publicly listed companies, all members should have a background or experience in finance, accounting, and audit. Moreover, the majority of the audit committee should be independent, including the committee chairman.

While the 2002 and 2009 Codes did not recommend the establishment of a nomination committee or a compensation and remuneration committee, it is mentioned that the board may create such committees, with at least one member being an independent director. However, the chair of either committee needs not be an independent director. In the 2017 Code, it is recommended that boards should establish a corporate governance committee that fulfills the functions of both the nomination and compensation/remuneration committees alluded to in the previous codes. This committee should be made up of at least three members, all of whom should be independent directors, including the committee chair.

Board Theories, Board Independence, Firm Performance, and Ownership Structure

Ownership concentration. The literature on the relationship between ownership concentration and board composition reports provide mixed results. On the one hand, Crespi-Cladera and Pascual-Fuster (2014) found that non-strict independent directors are more likely to be present among firms with widely held ownership, indicating that managers are more powerful than if these independent directors were strictly independent. On the other hand, large controlling shareholders may also be more likely to appoint non-strict independent directors who do not

interfere with their management practices, which exposes the minority shareholders to the possibility of expropriation (Chen & Nowland, 2010).

Agency theory. Different types of agency problems may arise depending on the ownership structure of the firm. In widely held firms where ownership is diffused, an agency problem arises between managers and shareholders. In this situation, managers have more power because it is difficult for a group of small shareholders to coordinate among themselves to properly monitor the actions of managers and ensure that they act on the interest of the shareholders. To potentially mitigate this problem, shareholders may appoint independent directors that limit managerial opportunism and monitor the plans and actions of management (Millstein & MacAvoy, 1998). On the other hand, in situations where ownership is highly concentrated, the interests of the large shareholders, the board, and management are likely to be aligned. In this case, the agency problem is between the controlling or large shareholders and minority shareholders. This may be problematic because it exposes the minority to wealth expropriation by the controlling shareholders unless certain corporate governance mechanisms are in place to prevent it (La Porta et al., 1999; Hermalin & Weisbach, 1991). Once again, independent directors may mitigate this problem by monitoring the actions of the controlling shareholders in the interest of minority shareholders.

Regardless of ownership structure, independent directors can potentially enhance the firm's value through their industry expertise and monitoring function; however, the controlling group, be it powerful managers or controlling shareholders, may not desire boards that monitor them intensely. Powerful managers may potentially influence shareholders to appoint friendly independent directors to reduce the board's monitoring ability, while large controlling shareholders may appoint friendly independent directors to give them more flexibility in running

the firm. This problem may be further exacerbated if non-strict independent directors have significant roles in board committees (i.e., the audit committee, nomination committee, and compensation and remuneration committee).³ Should these independent directors be appointed primarily to fulfill regulatory requirements concerning the proportion of independent directors on the board, this may indicate the presence of some severe agency problem in the firm (Crespi-Cladera & Pascual-Fuster, 2014). Instead of fulfilling their real purpose on the board as monitors and value-enhancers, these friendly or non-strict independent directors might allow for some degree of opportunism or wealth expropriation that may negatively affect the value of the firm.

Empirically, several studies support the idea that independent directors improve board performance through the monitoring of insider directors and managers and through the provision of outside expertise and unbiased counseling (Anderson & Reeb, 2004; Black, Jang, & Kim, 2006; Choi, Park, & Yoo, 2007; Chen & Nowland, 2010). However, there is also empirical evidence that board independence has an insignificant or negative effect on firm performance (Agrawal & Knoeber, 1996; Dalton, Daily, Ellstrand, & Johnson, 1998; Bhagat & Black, 2002; Fuzi, Halim, & Julizaerma, 2016; Cavaco, Crifo, Reberieux, & Roudaut, 2017). Moreover, some studies found that the effect of board independence may be moderated by the ownership structure of the firm (Leung, Richardson, & Jaggi, 2014; Liu et al., 2015). Some attribute the varying results to the fact that boards are endogenously determined (Hermalin & Weisbach, 2003), while others posited that results vary due to the different market environments in which these firms operate (Choi et al., 2007; Liu et al., 2015). The differing empirical results in the literature bring to question the effectiveness of a one-size-fits-all policy for independent directorships.

³ Nguyen and Nielsen (2010) found that independent directors contribute greatly to firm performance through their roles in board committees. Benkel, Mather, and Ramsay (2006) also found that a larger presence of independent directors in the board and the audit committee reduces the amount of earnings management of the firm, especially for large firms.

Independent directors may be effective at mitigating the agency problem and improving value in some situations, but they may also erode value in other instances.

Optimal board independence theory. The optimal board independence theory suggests that a one-size-fits-all policy for board independence does not necessarily achieve shareholder interests.⁴ In this case, different boards may have different optimal degrees of board independence. This theory suggests that for some firms, friendly boards (i.e., non-strictly independent directors) might be optimal for shareholder value. This implies that firms may appoint non-strictly independent directors to achieve their optimal level of board independence, while at the same time satisfying the recommended level of independence. If this theory holds, appointing such directors will not negatively affect firm value. In fact, because these non-strictly independent directors are being appointed to reach the optimal level of board independence, the presence of such directors might even positively impact firm value.

Likewise, firms may continue appointing non-strict independent directors to reach the recommended level of board independence even if such firms have already previously reached their optimal level of independence. In this case, the optimal board independence theory posits an insignificant relationship between the presence of non-strict independent directors and firm performance because such directors, regardless of their outside expertise or monitoring ability, are merely used as window-dressing by firms to satisfy regulatory requirements pertaining to board independence.

Consistent with the optimal board independence theory, Adams and Ferreira (2007) showed that there is an optimal level of board independence that induces managers to divulge enough information to the board for the board to function in a firm value-maximizing manner.

⁴ The optimal board independence theory was first conceptualized by Crespi-Cladera and Pascual-Fuster (2014) based on several theoretical and empirical studies that do not find evidence of firm performance improving as a result of greater board independence.

Hermalin and Weisbach (1998) also found that the presence of strictly independent directors may not be desirable when the firm is performing well. Crespi-Cladera and Pascual-Fuster (2014) found empirical evidence that non-strict board independence has no significant effect on the performance of Spanish publicly listed firms, whereas Cavaco et al. (2017) suggested that these independent directors among Spanish firms are primarily appointed to satisfy regulatory requirements. Furthermore, Coles, Daniel, and Naveen (2008) questioned the conventional wisdom that smaller and more independent boards are more effective and argue that the effectiveness of board composition on firm performance is driven by the heterogeneities between simple and complex firms.

Hypotheses Development

Model 1: Presence of non-strict independent directors and ownership structure.

Based on the preceding discussion, ownership concentration may have a positive or negative effect on the probability of a non-strict independent director being on the board. A positive relationship indicates that firms with concentrated ownership are more likely to have non-strict independent directors on the board while a negative relationship indicates that widely held firms are more likely to have non-strict independent directors on the board.

H_1 : Ownership concentration may have a positive or negative effect on the likelihood of the presence of a non-strict independent director on the board.

Model 2: Effect of non-strict independent directors on firm performance. Agency theory posits that the presence of non-strict independent directors on the board points to a severe agency problem within the firm, be it a conflict of interest between managers and shareholders in widely held firms or between large shareholders and minority shareholders in firms with concentrated ownership. On the other hand, if the optimal board independence theory holds, non-

strict independent directors are not used to mask some form of agency problem, but instead, are used to achieve the optimal level of independence while satisfying the recommended level of board independence.

H_2 : If the agency theory holds, the proportion of non-strict independent directors will have a negative effect on firm performance.

H_3 : If the optimal board independence theory holds, the proportion of non-strict independent directors will have an insignificant or positive effect on firm performance.

Model 3: Effect of non-strict independent directors in the audit committee on firm performance. Similar to the prediction of agency theory in Model 2, the presence of non-strict independent directors in board committees may mask some agency problem in the firm because the internal monitoring system of the firm may not be as stringent or as transparent than when the audit committee has members that are strictly independent directors. On the other hand, if the optimal board independence theory holds, the presence of non-strict independent directors in the audit committee may be indicative of firms trying to balance the optimal level of monitoring and control with the level of discretion held by managers.

H_4 : If the agency theory holds, the proportion of non-strict independent directors in the audit committee will have a negative effect on firm performance.

H_5 : If the optimal board independence theory holds, the proportion of non-strict independent directors in the audit committee will have an insignificant or positive effect on firm performance.

H_6 : If the agency theory holds, firm performance will be lower if the chair of the audit committee is a non-strict independent director.

H_7 : If the optimal board independence theory holds, firm performance will be higher if the chair of the audit committee is a non-strict independent director.

Data, Empirical Model, Hypotheses Development, and Methodology

Sample and Data Collection

We hand-collected data used to construct our board structure, ownership structure, firm size, and firm age variables from the Annual Reports, Public Ownership Reports, and Annual Corporate Governance Reports (ACGRs) submitted by Philippine publicly listed firms to the Securities and Exchange Commission and the Philippine Stock Exchange. Firm-level financial data required to construct our measures of firm leverage and growth opportunities are obtained from Annual Reports and the Thomson Reuters financial database. We constructed an unbalanced panel dataset that spans the period 2012 to 2015.⁵ Firms that did not trade and have missing data are excluded from the sample. Table 1 summarizes the sample data elimination process. Our final sample consists of 926 firm-year observations.

Table 1
Sample Data Elimination

	2015	2014	2013	2012	Total
Initial Sample	263	260	255	255	1033
Firms that did not trade	(0)	(16)	(18)	(19)	(53)
Firms that have missing data	(16)	(11)	(13)	(14) ⁶	(54)
Total	247	233	224	222	926

⁵ The SEC started requiring all listed companies to submit their ACGRs starting from 2012, which we then chose as the start of our sample period. The ACGR is a more accurate source of the information necessary to determine the classification of a director (whether a director is an independent director, an executive, or a non-executive other than an independent director) and to verify whether or not the declared independent directors satisfy the 12 criteria of strict independence.

⁶ Two firms have been excluded from the sample since they did not declare any independent director during this year.

Strict Independence Definition

In the Philippines, the definition of board independence in the 2017 Code is a response to recent developments in corporate governance and an attempt to align with international best practices and standards. The stringency of the criteria for independents increased marginally from the 2002 Code to the major revisions stipulated in the 2009 Revised Code; however, the 2017 Code adds several new criteria for independence and updates several older criteria to conform to the standards of more developed markets. Consequently, we based our definition of strict independence on the criteria for independence outlined in the 2017 Code. In this study, satisfying the criteria for independence in the 2017 Code indicates that an independent director is truly independent. For an independent director to be classified as a strictly independent director, the individual must satisfy all 12 criteria used to define an independent director in the 2017 Code.⁷ The 12-point criteria from Recommendation 5.2 of the 2017 Code are as follows (SEC Memorandum Circular No. 19 Series of 2016, 2016)):

1. Is not and has not been an employee of the covered company;
2. Is not and has not been affiliated as an employee/director of a group-affiliated company;
3. Is not and has not been appointed on any advisory board;
4. Is not an owner of two percent or more shares;
5. Is not related to a director, executive, and/or shareholder;
6. Is not acting as a nominee;
7. Is not a securities broker-dealer of listed companies;
8. Is not an adviser of the covered company;
9. Does not have material interest in the operations of the covered company;

⁷ Table A of Appendix A shows a comparison of the criteria for independent directors listed in the 2017 Code with that of the 2002 Code and 2009 Revised Code (as amended).

10. Is not involved with any non-profit organization that receives funding from the covered company;
11. Does not interlock with any fellow director;
12. Has not been an independent director (ID) for more than nine years.

Model 1: Presence of Non-Strict Independent Directors and Ownership Concentration

Similar to Crespi-Cladera and Pascual-Fuster (2014), we tested our first hypothesis by estimating Equation (1) that relates the presence of non-strict independent directors in a firm to the firm's ownership structure and other factors purported to affect the incidence of non-strict independent directors.

$$\begin{aligned}
 PNSID_{i,t} = & \beta_0 + \beta_1 TopOwn_{i,t} + \beta_2 Fsize_{i,t} + \beta_3 Dual_{i,t} + \beta_4 Bsize_{i,t} + \beta_5 Busy_{i,t} \\
 & + \beta_6 Interlock_{i,t} + \sum_{z=1}^{Z-1} \vartheta_z Indus_{z,i,t} + \sum_{t=1}^T \delta_t Year_t + \epsilon_{i,t}
 \end{aligned} \tag{1}$$

The dependent variable, the presence of non-strict independence (*PNSID*), is a dummy variable that takes the value of 1 when at least one non-strict independent director sits on the board and 0 otherwise. Our main independent variable of interest is the firm's ownership concentration (*TopOwn*) which is the percentage ownership of the largest shareholder.⁸

We included control variables that can potentially affect the presence of non-strict independent directors. The first set of these variables proxy for managerial power: CEO duality (*Dual*), board size (*Bsize*), board busyness (*Busy*), and interlocking directorates (*Interlock*). *Dual* is a dummy variable that takes on the value of 1 when the Chair and CEO are the same person and 0 otherwise. *Bsize* is the natural logarithm of the number of directors on the board. *Busy* is

⁸ This measure of ownership concentration captures the proportion of shares that have the same interest. For firms that are affiliated with a family or family corporate group, we use the total ownership of the family members or the total interest of the entities affiliated with the family.

the ratio of the number of busy non-executive directors to board size, where busy directors are defined as those with three or more directorships in their portfolio (Fich & Shivdasani, 2007). *Interlock* is measured as the ratio of the number of interlocked executive directors to board size. An interlocking executive director is defined as an executive director who serves as a non-executive in another firm with an executive director who serves as a non-executive director in the first firm (Hallock, 1997).

We also included the variable *Fsize*, the natural logarithm of the firm's market capitalization, to control for any effect related to the size of the firm. Industry (*Industry*) and year (*Year*) dummies are included as well to control for industry-wide and macroeconomic effects that may affect the presence of non-strict independent directors in a firm.⁹

Similar to Crespi-Cladera and Pascual-Fuster (2014), we estimated this binary response model using three alternative logit models for robustness checking of our results: (1) a pooled logit regression model with robust standard errors clustered by firms, (2) a random effects panel data logit model, and (3) a generalized estimating equations (GEE) panel data logit model. The GEE estimation technique, developed by Zeger and Liang (1986) and Liang and Zeger (1986), is a semiparametric technique that uses quasi-likelihood estimation rather than maximum-likelihood estimation. This method is akin to the feasible generalized linear models (Crespi-Cladera & Pascual-Fuster, 2014). In specifying the GEE model, we set the distribution of the dependent variable to binomial, the link function to the logit or the logistic function, and the

⁹ We classified our firms according to the Philippine Stock Exchange (PSE) sectoral classification system. In this study, we used the Mining and Oil sector as our base industry, and we used 2012 as our base year.

correlation structure to an autoregressive structure¹⁰ to account for the persistence of the presence of non-strict independent directors in the board over time.¹¹

Model 2: Firm Performance, Non-Strict Board Independence, and Ownership Structure

To analyze the effect of non-strict independence and ownership structure on firm performance and to test our second and third hypotheses, we estimated Equation (2).

$$Perf_{i,t} = \alpha_0 + \alpha_1 NSID_{i,t-1} + \alpha_2 TopOwn_{i,t-1} + \alpha_3 (TopOwn_{i,t-1} \times NSID_{i,t-1}) + \Phi C_{i,t-1} + \sum_{t=1}^{T-1} \delta_t Year_t + \sum_{i=1}^I \vartheta_z Indus_{z,i,t} + \epsilon_{i,t} \quad (2)$$

where the elements of the vector $C_{i,t}$ are

$$C_{i,t-1} = \begin{bmatrix} Fsize_{i,t-1} \\ Fgrowth_{i,t-1} \\ Flev_{i,t-1} \\ Fage_{i,t-1} \\ Dual_{i,t-1} \\ ED_{i,t-1} \\ Bsize_{i,t-1} \\ EDown_{i,t-1} \\ NEDown_{i,t-1} \\ Busy_{i,t-1} \\ Interlock_{i,t-1} \end{bmatrix}$$

and $\epsilon_{i,t}$ is the stochastic disturbance term. All independent variables are one-period lagged values to mitigate endogeneity issues (Hermalin & Weisbach, 2003).¹²

¹⁰ We also used the quasi-likelihood under the independence model criterion developed by Pan (2001) as a guide to determine the most informative within-group correlation structure.

¹¹ Ballinger (2004) wrote a brief and insightful paper on the uses, weaknesses, and application of using GEE for longitudinal data.

¹² We attempted to estimate Model 2 using the two-step system GMM approach proposed by Arellano-Bond (1991) and Blundell-Bond (1998) to control for endogeneity. However, our results do not pass the specification tests, most probably because of our very limited sample period. Moreover, we did not include any lagged dependent variable as an explanatory variable because (1) adding such variable introduces joint endogeneity problems between it and other independent variables, and (2) Nickell (1981) has shown that including a dynamic element to within-group estimators produces estimates that are biased and inconsistent. As a result, we used the fixed effects estimator to estimate Equation 2.

The dependent variable *Perf* is the firm's performance measure. In this study, we employed three accounting-based measures of firm performance: return on assets (*ROA*), return on equity (*ROE*), and negative profit (*NEGPROF*). *ROA* is computed as net income plus interest expenses net of tax effects (*EBIAT*) divided by the book value of assets (*BVA*) of the previous period; *ROE* is computed as *EBIAT* divided by the book value of equity (*BVE*) of the previous period; and *NEGPROF* is a dummy variable that takes the value of 1 if a firm's *EBIAT* is negative and 0 otherwise.¹³

Similar to Crespi-Cladera and Pascual-Fuster (2014), *NSID* is the ratio of the number of non-strict independent directors to the total number of directors on the board. *TopOwn* is as defined in Model 1. We included an interaction term between ownership and non-strict independence ($TopOwn \times NSID$) to investigate whether there is a differential effect of non-strict independent directors on firm performance based on the firm's ownership structure.

We controlled for firm characteristics that may affect firm performance including firm size (*Fsize*) as measured previously, firm growth opportunities (*Fgrowth*) proxied by the one-period lagged market-to-book asset ratio,¹⁴ leverage (*Flev*) as the ratio of long-term debt to total assets,¹⁵ and firm age (*Fage*) measured as the natural logarithm of the number of years since the firm's date of incorporation.

Moreover, we controlled for a firm's corporate governance structure captured by a set of variables including CEO duality (*Dual*), the proportion of executive directors on the board (*ED*),

¹³ We winsorize *ROA* and *ROE* at the 1st and 99th percentiles to mitigate the effect of outliers.

¹⁴ This is the ratio of the sum of the market value of common equity, book value of preferred shares, and book value of total debt less deferred tax liabilities to the book value of total assets. Adam and Goyal (2007) discussed and evaluate the performance of alternative proxies for a firm's investment opportunities and found that the market-to-book asset ratio contains the highest information content with respect to investment opportunities. Like *ROA* and *ROE*, we winsorized *Fgrowth* at the 1st and 99th percentiles to mitigate the effect of outliers.

¹⁵ For robustness checks, we also used two other alternative measures of leverage: (1) ratio of total debt to total assets and (2) ratio of total debt to the sum of market value of common equity and total debt, following Schultz, Tian, and Twite (2013). The results using either alternative leverage measure are qualitatively similar and are available upon request.

board size (*Bsize*), executive director ownership (*EDown*), non-executive director ownership (*NEDown*), board busyness (*Busy*), and interlocking directorates (*Interlock*). CEO duality, board size, board busyness, and interlocking directorates are as defined in Model 1. *ED* is the ratio of the number of executive directors to the total number of directors. *EDown* is the percentage of outstanding shares owned by executive directors; *NEDown* is the percentage of outstanding shares owned by non-executive directors (NEDs). *Dual* and *ED* are both measures of managerial power (Crespi-Cladera & Pascual-Fuster, 2014), whereas *Bsize* is a measure of board coordination problems (Yermack, 1996). *EDown* and *NEDown* both represent the ownership stake of the board, *Busy* controls for NEDs with commitment issues (Fich & Shivdasani, 2007), and *Interlock* represents the monitoring effort of NEDs (Hallock, 1997). We also included industry (*Industry*) and year (*Year*) dummies in the model to account for industry-specific effects and market-wide effects that vary over time. The complete list and definition of all variables used in this study is found in Appendix D.

According to Adams, Hermalin, and Weisbach (2010), empirical research on corporate governance topics is difficult to conduct because of the interrelatedness of corporate governance variables and firm performance measures. Endogeneity issues arise because the direction of causation between governance variables and performance may go either way; this makes inference difficult because resulting parameter estimates may be biased or inconsistent (Liu et al., 2015). In our case, simultaneity could arise from the bidirectional causality between firm performance and several of our independent variables such as non-strict independence, firm size, and board size. Similar to the approach of Dittman, Maug, and Schneider (2010) and Joecks, Pull, and Vetter (2013), we addressed the issue of endogeneity by using one-period lagged explanatory variables as our regressors (except for the firm and year dummies). In effect, we are

estimating the impact of the explanatory variables on future performance. Also, we estimated Equation 2 using two-way fixed effects and random effects regression models and used Huber-White robust standard errors (robust standard errors clustered by the firm).

Model 3: Firm Performance, Non-Strict Board Independence in the Audit Committee, and Ownership Structure

Unlike Crespi-Cladera and Pascual-Fuster (2014), we analyzed only the effect of the presence of non-strict independent directors in the audit committee on firm performance since the creation of the nomination, and compensation/remuneration committees have not been recommended in the code of corporate governance that covers our sample period.

To analyze the effects of non-strict independence in the audit committee and ownership structure on firm performance and to test our fourth to seventh hypotheses, we estimated Equation (3).

$$Perf_{i,t} = \alpha_0 + \alpha_1 AC_{i,t-1} + \alpha_2 TopOwn_{i,t-1} + \alpha_3 (TopOwn_{i,t-1} \times AC_{i,t-1}) + \Phi C_{i,t-1} + \sum_{t=1}^{T-1} \delta_t Year_t + \sum_{i=1}^{I-1} \vartheta_z Indus_{z,i,t} + \epsilon_{i,t} \quad (3)$$

where the elements of the vector $C_{i,t}$ are

$$C_{i,t-1} = \begin{bmatrix} Fsize_{i,t-1} \\ Fgrowth_{i,t-1} \\ Flev_{i,t-1} \\ Fage_{i,t-1} \\ Dual_{i,t-1} \\ ED_{i,t-1} \\ Bsize_{i,t-1} \\ EDown_{i,t-1} \\ NEDown_{i,t-1} \\ Busy_{i,t-1} \\ Interlock_{i,t-1} \end{bmatrix}$$

and $\epsilon_{i,t}$ is the stochastic disturbance term. All independent variables are one-period lagged values to mitigate endogeneity issues (Hermalin & Weisbach, 2003).

Similar to Crespi-Cladera and Pascual-Fuster (2014), we measured the involvement of non-strict independent directors in the audit committee (AC) using two alternative proxy variables. The first measure is the proportion of audit committee members that are non-strict independent directors (*ACNSID*). The second measure is a dummy variable that takes the value of 1 if the audit committee chair is a non-strict independent director and 0 otherwise (*ACNSIDCHAIR*). We included an interaction term between ownership and non-strict independence in the audit committee (*TopOwn* × *AC*) to investigate if there is a differential effect of the power of non-strict independent directors in the audit committee on firm performance based on the firm’s ownership structure. The dependent variable and all other independent variables are as defined in Model 2.

Results and Discussion

Descriptive Statistics

Table 2
*Independence Criteria Non-Compliance Among Declared Independent Directors*¹⁶

	1	2	3	4	5	6	7	8	9	10	11	12
2015	1.46%	33.88%	0.33%	0	0.81%	6.84%	0	0.16%	3.41%	0	0.49%	26.18%
2014	1.58%	32.81%	0.35%	0	0.70%	7.89%	0	0	3.33%	0	0.35%	23.68%
2013	1.82%	29.01%	0.18%	0	0.36%	6.39%	0	0	2.55%	0	0.55%	21.90%
2012	1.87%	31.53%	0	0.37%	0	3.54%	0	0	2.24%	0	0.56%	21.46%
Ave.	1.68%	31.81%	0.21%	0.09%	0.47%	6.16%	0	0.04%	2.89%	0	0.49%	23.30%

Table 2 reports the proportions of declared independent directors that have not satisfied each specific criterion of independence used in this study. The top three criteria that are commonly not met by all declared independent directors are 2, 12, and 6, which correspond to policies on directorships in group-affiliated firms, tenure as independent director, and nominee

¹⁶ The figure 0 indicates that all declared independent directors in the sample complied with the criterion during the year.

status, respectively. On the other hand, the criteria that are most commonly met are 8 and 4, which correspond to requirements pertaining to affiliation with the firm as an adviser and independent director share ownership, respectively.

The criteria that are most commonly not satisfied (criteria 2 and 12) are those that require the independent director to have not been affiliated as an employee/director of a group-affiliated company and to have not been an independent director for more than nine years. Close to a third of the declared independent directors have employee or director positions in other companies (public or privately-held) that are affiliated with the publicly traded firm in which they happen to be an independent director. On the other hand, close to a fifth of declared independent directors have exceeded the nine-year tenure limit. The non-compliance with the 2nd criterion indicates that many of the declared independent directors tend to carry multiple positions within the same business group, implying that such independent directors have a bigger role in the business group other than just monitoring, advising, and overseeing the publicly traded firm. On the other hand, non-compliance with the 12th criterion suggests that shareholders choose to re-appoint independent directors that have exceeded the tenure limit rather than appoint new independent directors that satisfy this criterion. All in all, non-compliance with both criteria may indicate that these directors are of great value to the firm and that comparable replacements are difficult to find.

Table 3
Summary of Independent and Non-Strict Independent Director Statistics

	2015	2014	2013	2012	Average
<i>Panel A</i>					
Firms with non-strict independent directors	169	156	143	147	
% of firms with non-strict independent directors	68.42%	66.95%	63.84%	66.22%	66.36%
<i>Panel B</i>					
Number of declared ID positions across the sample	615	570	548	536	
Number of declared ID positions occupied by	332	307	263	258	

non-strict independent directors					
% of declared ID positions occupied by non-strict independent directors	53.98%	53.86%	47.99%	48.13%	50.99%
<i>Panel C.1</i>					
Number of individuals who are declared as IDs	453	423	411	405	
Number of non-strict independent directors	241	230	194	191	
% of non-strict independent directors	53.20%	54.34%	47.20%	47.16%	50.48%
<i>Panel C.2</i>					
Number of individuals who are IDs in Philippine publicly listed firms	453	423	411	405	
% with ID position in 1 firm	81.46%	80.38%	80.78%	80.74%	80.84%
% with ID position in 2 firms	10.60%	13.00%	13.14%	12.59%	12.33%
% with ID position in 3 firms	3.75%	2.84%	2.43%	3.70%	3.18%
% with ID position in more than 3 firms	4.19%	3.78%	3.65%	2.96%	3.65%

Table 3 shows some statistics on the state of independent directorships among the firms in our sample. Based on Panel A, 66.36% of our sample firms on average have at least one non-strict independent director on the board. These results are relatively similar to that of Crespi-Cladera and Pascual-Fuster (2014) who found that 69.80% of the firms in their sample have independent directors that do not comply with their criteria for independence.

Panel B of Table 3 presents the number of declared independent director positions each year and the number of these positions occupied by non-strict independent directors. On average, 50.99% of the declared independent directors can be classified as non-strict independent directors. Panel C.1 of Table 3 shows the number of individuals who occupy the declared independent director positions across our sample period. This panel shows that, on average, 50.48% of these individuals are misclassified as independent directors. A comparison of the figures in Panel B and Panel C.1 indicates instances of individuals having multiple independent directorships in publicly listed firms in the Philippines. Panel C.2 shows that on average, 80.84% of individuals declared as independent directors have one independent directorship in a publicly

listed firm, and about 19.17% of such individuals have more than one independent directorship in a publicly listed firm.

Table 4

Presence of Non-Strict Independent Directors Among Firms by Ownership Concentration

	2015	2014	2013	2012	
Number of firms	247	233	224	222	926 firm-year observations
<i>Group 1: At least 50% of outstanding shares owned by the Top Owner</i>					
Number of firms	137	135	132	132	536 firm-year observations
Firms that have a non-strict independent director on the board	107	100	89	91	387 firm-year observations
Proportion of firms that have a non-strict independent director to number of firms	78.10%	74.07%	67.42%	68.94%	72.13%
<i>Group 2: Less than 50% of outstanding shares owned by the Top Owner</i>					
Number of firms	85	87	90	90	352 firm-year observations
Firms that have a non-strict independent director on the board	62	56	54	56	228 firm-year observations
Proportion of firms that have a non-strict independent director to number of firms	72.94%	64.37%	60.00%	62.22%	64.88%

Table 4 reports the distribution of non-strict independent directors across: (1) firms where the top owner owns at least 50% of outstanding shares and (2) firms where the top owner owns less than 50% of outstanding shares. Based on this table, we find that more than half of firms

across all years have a top shareholder who owns more than 50% of the company, again implying that ownership is highly concentrated among Philippine publicly listed firms. In terms of the appointment of non-strict independent directors, we find that 72.13% of firms with at least 50% ownership by the top shareholder have a non-strict independent director on the board when compared to 64.88% for firms with less than 50% ownership by the top shareholder. This indicates that firms with higher ownership concentration (72.13%) tend to have a greater presence of non-strict independent directors on the board than do firms with lower ownership concentration (64.88%).

Table 5

Presence of Non-Strict Independent Directors in Audit Committees of Publicly Listed Firms

	2015	2014	2013	2012	
<i>Panel A</i>					
Number of Firms	246	245	236	223	
Proportion of audit committee that is ID	48.63%	47.76%	47.28%	47.74%	47.86%
Proportion of audit committee that is NSID	27.14%	26.05%	23.39%	23.51%	25.02%
Difference	21.50%	21.71%	23.89%	24.24%	22.83%
<i>Panel B</i>					
Number of Firms	245	244	237	224	
Proportion of sample with ID as audit committee chair	97.55%	96.72%	97.89%	97.32%	97.37%
Proportion of sample with NSID as audit committee chair	56.90%	55.51%	54.31%	53.67%	55.10%
Difference	40.65%	41.21%	43.58%	43.65%	42.27%

Table 5 reports the involvement of non-strict independent directors in the audit committee. Based on Panel A of Table 5, we find that on average, audit committees consist of close to 50% independent directors; however, on average, more than half of these independent directors are non-strict independent directors. On the other hand, Panel B shows us that around

97% of firms have an independent director as audit committee chair, but more than 50% of these firms in each year have a non-strict independent director as audit committee chair. These results are unsurprising and may be a consequence of firms choosing to appoint non-strict independent directors as evidenced by the figures from Table 3, where more than 50% of all declared independent directors are non-strict independent directors.

Table 6*Summary of Descriptive Statistics*

	Mean	Std. Dev.	Min	Max
<i>Board Independence:</i>				
% of Non-Strict Independent directors (NSID)	13.14%	12.24%	0%	72.73%
Presence of Non-strict Independent Directors	66.63%	47.18%	0	1
% of Audit Committee that is classified as NSID	25.57%	24.28%	0	100%
Audit Committee Chair is NSID	55.85%	49.69%	0	1
<i>Ownership Structure:</i>				
Top Ownership	54.85%	22.31%	0.28%	99.94%
<i>Firm Characteristics:</i>				
Market Capitalization (PhP)	43,000,000,000	97,100,000,000	11,000,000	694,000,000,000
Market-to-Book Asset Ratio	7.65	40.46	0.3716	350.09
Leverage	9.58	14.83	0	117.67
Firm Age (Years)	41.33	24.60	1.0376	112.39
<i>Corporate Governance Structure:</i>				
CEO Duality	39.20%	48.85	0	1
Executive Director Proportion	31.03%	16.31%	6.67%	81.82%
Board Size (number of directors on the board)	9.48	2.26	5	15
Executive Directors' Ownership	8.96%	18.52%	0	91.22%
Non-Executive Directors' Ownership	2.66%	7.98%	0	75.19%
Board Busyness	53.41%	21.82%	0	93.75%
Interlocking Directorates	2.62%	6.13%	0	44.44%
<i>Firm Performance:</i>				
Return on Assets	4.44%	16.67%	-68.48%	91.93%
Return on Equity	10.72%	29.64%	-108.32%	155.97%
Negative Profit	23.87%	42.65%	0	1

Table 6 reports the mean, standard deviation, minimum, and maximum values for the variables used in this study. We find that on average, 13.14% of the board is comprised of non-strict independent directors, which is lower than Crespi-Cladera and Pascual-Fuster's (2014) 18.31% figure for Spanish publicly listed firms. Moreover, we observe that 66.63% of our firm-year observations have at least one non-strict independent director on the board. We also find that, on average, 25.57% of audit committees are comprised of non-strict independent directors, slightly lower than Crespi-Cladera and Pascual-Fuster's (2014) figure of 28.20%, and around 55.85% of firms have a non-strict independent director as chair of the audit committee. In terms of ownership concentration, an average firm has a top shareholder who owns 54.85% of the firm's outstanding shares, much higher than the 36.39% figure reported by Crespi-Cladera and Pascual-Fuster (2014) for the Spanish equity market.

The average firm size in our sample in terms of market capitalization is PhP43 billion. A typical firm has been operating for 41 years since its date of incorporation, has a leverage ratio of 9.58, and a market-to-book asset ratio of 7.65.

For the corporate governance structure of the firms in our sample, 39.20% of our firm-year observations have CEOs who also serve as the Chair of the Board. On average, the board of directors is comprised of nine members, 31.03% of which are executive directors. These executive directors own, on average, 8.95% of the firm's outstanding common shares, which is higher than the average ownership of 2.66% for non-executive directors. Moreover, on average, 53.41% of the board members are non-executive directors who hold three or more directorships in their portfolio, and 2.62% of the board members are executive directors who have interlocking board positions.

In terms of performance variables, firms, on average, have an *ROA* of 4.44% and *ROE* of 10.72%. In addition, around 23.87% of firm-year observations in our sample have negative profitability, as measured by earnings before interest net of taxes.

Model 1 Results and Discussion

Table 7

Results for Model 1: Presence of Non-Strict Independent Director

The dependent variable is the presence of non-strict independent directors, a dummy variable that takes the value of 1 when a non-strict independent director is on the board and 0 otherwise. The control variables are *TopOwn* as measured by the percentage ownership of the largest shareholder; *Firm Size* as the natural logarithm of the market capitalization of the firm; *CEO Duality* as a dummy variable that takes the value of 1 when the CEO is also the Chair of the board and 0 otherwise; *Board Size* as the natural logarithm of the number of directors on the board; *Busyness* as the ratio of the number of busy non-executive directors to board size; and *Interlock* as the ratio of the number of interlocked executive directors to board size. The LR Test shows the results of the likelihood ratio test (i.e. random effects logistic model is more appropriate than the logit model). Lastly, the Chi2 statistic presents the results for the overall significance of the model. The coefficient estimates for all these regressions are the average marginal effects, and robust standard errors are shown in parentheses. *** denotes significance at the 1% level; ** denotes significance at the 5% level; and * denotes significance at the 10% level.

Variable	GEE	RELM	Logit
<i>TopOwn</i>	0.0112** (0.0046)	0.0292** (0.0139)	0.0087 (0.0057)
<i>Firm Size</i>	-0.0512 (0.0515)	-0.2593 (0.1631)	-0.0975 (0.0631)
<i>CEO Duality</i>	-0.2614 (0.1961)	-0.3498 (0.5022)	-0.1602 (0.2375)
<i>Board Size</i>	2.4257*** (0.5156)	6.3896*** (1.6171)	2.3479*** (0.6229)
<i>Busyness</i>	0.0543*** (0.0092)	0.1609*** (0.0322)	0.0731*** (0.0121)
<i>Interlocking</i>	-0.0157 (0.0123)	-0.0251 (0.0391)	-0.0031 (0.0199)
LR Test	-	282.86	-
Chi2	61.37***	62.02***	48.52***
Industry	Yes	Yes	Yes
Year	Yes	Yes	Yes
Observations	901	926	926

The GEE regression uses only 901 observations instead of the full 926 observations because this model requires at least two consecutive years in the sample. We excluded six firm-years for having non-consecutive observations and 19 firm-years due to having only one observation.

Table 7 reports the results of estimating Equation 1 where the dependent variable is the presence of non-strict independent directors on the board. We estimate Equation 1 using: (1) generalized estimating equations (GEE), (2) random effects logistic estimation (RELM), and (3) logistic regression estimation (Logit).

Contrary to the findings of Crespi-Cladera and Pascual-Fuster (2014), our GEE and RELM estimation results indicate a positive and significant relationship between ownership concentration and the likelihood that a non-strict independent director is present on the board. This suggests that the larger the ownership share of the firm's top owner is, the more likely that the firm has a non-strict independent director on the board. Such finding is also consistent with the summary statistics reported in Table 4, which indicate the greater presence of non-strict independent directors among firms with more concentrated ownership (72.13%) than among firms with less concentrated ownership (64.88%).

We also find significant evidence that larger and busier boards are more likely to have non-strict independent directors on the board. Such boards may indicate the presence of board monitoring problems that exist due to a lack of commitment and unclear responsibilities among board members (Yermack, 1996). Lastly, we find no significant evidence that CEO duality and interlocking directorates affect the likelihood of having a non-strict independent director on the board. These results indicate that powerful CEOs are equally likely as their non-powerful counterparts to require the presence of friendly independent directors.

All in all, we find some significant evidence that firms with large controlling shareholders tend to have more non-strict independent directors. To confirm whether controlling shareholders appoint more non-strict independent directors to the board to mask agency problems, we estimate and present the results for Model 2 in the next section.

Model 2 Results and Discussion

Table 8

Panel Estimation Results for Model 2: Firm Performance and Non-Strict Independence

The dependent variable is Firm Performance, as measured by *ROA*, *ROE*, or *NEGPROF*. *ROA* is computed as net income plus interest expenses net of tax effects (*EBIAT*) divided by the book value of assets of the previous period; *ROE* is computed as *EBIAT* divided by the book value of equity of the previous period; *NEGPROF* is a dummy variable equal to 1 when the firm's *EBIAT* is negative and 0 otherwise. *NSID* is the ratio of the number of non-strict independent directors to the total number of directors on the board; *TopOwn* is the percentage ownership of the largest shareholder; *Firm Size* is the natural logarithm of the book value of total assets; *Growth Opportunities* is proxied by the one-period lagged market-to-book asset ratio; *Leverage* is the ratio of long-term debt to total assets; *Firm Age* is the natural logarithm of the number of years since the firm's date of incorporation; *CEO Duality* is a dummy variable that takes on the value of 1 when the CEO is also the Chair of the board and 0 otherwise; *ED Proportion* is the proportion of executive directors on the board; *Board Size* is the natural logarithm of the number of directors on the board; *EDown* is the percentage of outstanding shares owned by executive directors; *NEDown* is the percentage of outstanding shares owned by non-executive directors; *Busyness* is the ratio of the number of busy non-executive directors to board size; *Interlock* is measured as the ratio of the number of interlocked executive directors to board size. The test statistics of the various specification tests are also reported. BPLM test is the Breusch-Pagan Lagrange Multiplier used to test for random effects; Wald's test is used to examine whether there are fixed effects; Hausman test is used to determine whether the random effects model suffers from biased and inconsistent estimates; LR Test is analogous to the BPLM test but for logistic regressions. The results of these tests indicate that the Fixed Effects model is appropriate for regression models 1 to 4, while random effects logistic model is appropriate for models 5 and 6. The coefficient estimates for columns 5 and 6 are the average marginal effects. Figures in parentheses are cluster-robust standard errors. *** denotes significance at the 1% level; ** denotes significance at the 5% level; and * denotes significance at the 10% level.

Dependent Variable	ROA			ROE		NEGPROF
	1	2	3	4	5	6
<i>NSID</i>	-0.0944 (0.0927)	-0.219 (0.1877)	-0.0717 (0.1810)	-0.4242 (0.3317)	-0.0371 (0.0234)	0.0568 (0.0470)
<i>TopOwn</i>	0.1635 (0.1487)	0.1467 (0.1549)	0.4309 (0.2883)	0.3834 (0.3027)	0.0001 (0.0114)	0.0201 (0.0146)
<i>NSID x TopOwn</i>		0.0023 (0.0026)		0.0065 (0.0045)		-0.0019** (0.0009)
<i>Firm Size</i>	-2.4590* (1.4092)	-2.4283* (1.4025)	-2.836 (2.2583)	-2.7493 (2.2743)	-0.8853*** (0.1707)	-0.9222*** (0.1800)
<i>Growth Opportunities</i>	4.5661 (3.1654)	4.6041 (3.1731)	2.3591 (2.5049)	2.4667 (2.5074)	0.4023** (0.2016)	0.4218** (0.2077)
<i>Leverage</i>	0.182 (0.1106)	0.1792 (0.1153)	0.0837 (0.2122)	0.0758 (0.2130)	-0.015 (0.0171)	-0.0162 (0.0174)
<i>Firm Age</i>	3.2071 (9.7112)	3.2005 (9.6398)	-15.0367 (20.5289)	-15.0553 (20.1571)	-0.0962 (0.3998)	-0.0669 (0.4178)
<i>CEO Duality</i>	-3.3913 (4.0087)	-3.2974 (4.0341)	-7.9454 (6.3229)	-7.6796 (6.3860)	0.7273 (0.5276)	0.7496 (0.5457)

<i>ED Proportion</i>	0.0441 (0.1195)	0.047 (0.1219)	0.0171 (0.2243)	0.0253 (0.2309)	-0.0355** (0.0167)	-0.0367** (0.0173)
<i>Board Size</i>	-10.7214 (15.4649)	-10.5675 (15.5866)	-23.9911 (20.3034)	-23.5555 (20.5480)	-1.5832 (1.2866)	-1.8164 (1.3494)
<i>ED Ownership</i>	0.205 (0.1715)	0.2042 (0.1698)	0.2166 (0.2517)	0.2145 (0.2477)	0.0144 (0.0133)	0.0161 (0.0140)
<i>NED Ownership</i>	0.3167 (0.2099)	0.3275 (0.2081)	0.5795* (0.3104)	0.6099** (0.3040)	-0.0066 (0.0274)	-0.0154 (0.0287)
<i>Busyness</i>	0.0968 (0.1499)	0.1017 (0.1499)	0.1719 (0.2569)	0.1859 (0.2589)	-0.0353 (0.0247)	-0.0386 (0.0259)
<i>Interlock</i>	-0.1499 (0.1347)	-0.1491 (0.1353)	-0.0441 (0.3375)	-0.0418 (0.3385)	-0.0414 (0.0445)	-0.0431 (0.0463)
Industry	None	None	None	None	Yes	Yes
Years	Yes	Yes	Yes	Yes	Yes	Yes
Wald's Test	2.56***	2.56***	2.09***	2.10***	0.63	0.71
BPLM Test	41.96***	42.02***	43.14***	43.26***	-	-
LR Test	-	-	-	-	81.20***	84.02***
Hausman Test	64.25***	64.77***	24.52**	25.73**	-	-
Chi2	1.54*	1.51*	1.44	1.69**	53.90***	51.33***
Appropriate Model	Fixed Effects	Fixed Effects	Fixed Effects	Fixed Effects	Random Effects	Random Effects
Observations	669	669	669	669	669	669

Table 8 reports the results of estimating Equation 2. Columns (1) and (2) present the results using *ROA* as the measure of firm performance; Columns 3 and 4 present the results when *ROE* is used to measure firm performance; and Columns 5 and 6 report the results when *NEGPROF* is the measure of firm performance.

For our models using *ROA* and *ROE* as the firm performance measures, results of the Wald's test and the Breusch-Pagan Lagrange Multiplier (BPLM) test indicate the presence of firm-specific effects on firm performance. Furthermore, results of the Hausman specification test indicate that the fixed effects estimator is more appropriate for our data than the random effects estimator. On the other hand, for our models using *NEGPROF* as the firm performance measure, results of the likelihood ratio tests indicate that the random effects estimator is more appropriate for the data than the pooled logit estimator while the Wald's test indicates that fixed effects logistic regression is no better than the pooled logit estimator. Results of the Hausman test further confirm that the random effects estimator is more appropriate than the fixed effects estimator when using *NEGPROF* as the firm performance measure.

Overall, regardless of the performance measure used, we find that the presence of non-strict independent directors does not significantly affect firm performance. The finding of an insignificant relationship supports the optimal board independence theory, which posits that firms may appoint non-strict independent directors merely to satisfy the recommended levels of board independence, even if such directors may not be more or less impactful than their strictly independent counterparts when it comes to enhancing firm performance. Moreover, this implies that the appointment of non-strict independent directors does not mask any uncontrolled agency problems within the firm that reduce firm value, similar to the findings of Crespi-Cladera and Pascual-Fuster (2014).

Results from Model 1 show that firms with a higher degree of ownership concentration are more likely to have a non-strict independent director on the board; however, in Model 2, we find that the interaction term between top ownership and the proportion of non-strict independent directors ($NSID \times TopOwn$) is negative and significant when $NEGPROF$ is used as the firm performance measure. These results indicate that although firms with a higher degree of ownership concentration are more likely to have a non-strict independent director on the board, more non-strict independent directors also imply that firms with higher degrees of ownership concentration are less likely to suffer from negative profits. This evidence is consistent with the prediction of the optimal board independence theory.

We also find some significant evidence that larger firms have lower firm performance when ROA is used as the firm performance measure. It may be the case that larger firms are more susceptible to bureaucratic problems and are less technically efficient when adopting changes in their organizational structure (Yang & Chen, 2009). However, when using $NEGPROF$ as the performance measure, we find significant evidence that larger firms are less likely to have negative profits. This may be attributed to the more competitive and powerful nature of larger firms relative to smaller firms (Dogan, 2013). We also find some evidence that higher growth opportunities result in a higher likelihood of the firm experiencing negative profit.

For our corporate governance variables, we find some significant evidence that non-executive directors' share ownership improves firm performance. These results indicate that the ownership stake of non-executives on the board may motivate management to make sure that the firm performs well (Vu, Phan, & Le, 2017).

Model 3 Results and Discussion

Table 9

Panel Estimation Results: Firm Performance and the Proportion of AC That is NSID

The dependent variable is Firm Performance, as measured by *ROA*, *ROE*, or *NEGPROF*. *ROA* is computed as net income plus interest expenses net of tax effects (*EBIAT*) divided by the book value of assets of the previous period; *ROE* is computed as *EBIAT* divided by the book value of equity of the previous period; *NEGPROF* is a dummy variable equal to 1 when the firm's *EBIAT* is negative and 0 otherwise. *ACNSID* is the proportion of non-strict independent directors in the audit committee; *TopOwn* is the percentage ownership of the largest shareholder; *Firm Size* is the natural logarithm of the book value of total assets; *Growth Opportunities* is proxied by the one-period lagged market-to-book asset ratio; *Leverage* is the ratio of long-term debt to total assets; *Firm Age* is the natural logarithm of the number of years since the firm's date of incorporation; *CEO Duality* is a dummy variable that takes on the value of 1 when the CEO is also the Chair of the board and 0 otherwise; *ED Proportion* is the proportion of executive directors on the board; *Board Size* is the natural logarithm of the number of directors on the board; *EDown* is the percentage of outstanding shares owned by executive directors; *NEDown* is the percentage of outstanding shares owned by non-executive directors; *Busyness* is the ratio of the number of busy non-executive directors to board size; *Interlock* is measured as the ratio of the number of interlocked executive directors to board size. The test statistics of the various specification tests are also reported. BPLM test is the Breusch-Pagan Lagrange Multiplier used to test for random effects; Wald's test is used to examine whether there are fixed effects; Hausman test is used to determine whether the random effects model suffers from biased and inconsistent estimates; LR Test is analogous to the BPLM test but for logistic regressions. The results of these tests indicate that the Fixed Effects model is appropriate for regression models 1 to 4, while the random effects logistic model is appropriate for models 5 and 6. The coefficient estimates for columns 5 and 6 are the average marginal effects. Figures in parentheses are cluster-robust standard errors. *** denotes significance at the 1% level; ** denotes significance at the 5% level; and * denotes significance at the 10% level.

Dependent Variable	ROA		ROE		NEGPROF	
	1	2	3	4	5	6
<i>ACNSID</i>	-0.1006* (0.0591)	-0.3775*** (0.1437)	0.033 (0.0504)	-0.077 (0.1291)	-0.0181 (0.0114)	0.0106 (0.0256)
<i>TopOwn</i>	0.1254 (0.1027)	0.0484 (0.1029)	-0.039 (0.0547)	-0.084 (0.0752)	-0.0043 (0.0122)	0.0064 (0.0149)
<i>ACNSID x TopOwn</i>		0.0047** (0.0021)		0.002 (0.0021)		-0.0006 (0.0004)
<i>Firm Size</i>	-1.8881 (1.5427)	-1.8699 (1.5276)	2.2965*** (0.7708)	2.2933*** (0.7742)	-0.9555*** (0.1876)	-0.9586*** (0.1882)
<i>Growth Opportunities</i>	4.5467 (3.2051)	4.4799 (3.1718)	-0.0575 (2.1764)	-0.0968 (2.1588)	0.4080* (0.2088)	0.4259** (0.2094)
<i>Leverage</i>	0.1956* (0.1080)	0.1782 (0.1154)	0.1057 (0.1191)	0.1044 (0.1206)	-0.0123 (0.0178)	-0.0111 (0.0177)
<i>Firm Age</i>	4.4681 (9.0529)	3.1958 (8.7204)	0.482 (1.6973)	0.4947 (1.6983)	-0.1299 (0.4217)	-0.1125 (0.4210)
<i>CEO Duality</i>	-4.7477 (4.7508)	-3.8815 (4.8026)	-4.1448 (3.0250)	-4.0634 (3.0217)	0.9412* (0.5678)	0.9105 (0.5679)

<i>ED Proportion</i>	0.0369 (0.1245)	0.045 (0.1283)	0.1322 (0.0873)	0.1291 (0.0862)	-0.0384** (0.0179)	-0.0377** (0.0179)
<i>Board Size</i>	-11.7924 (17.6049)	-12.8521 (18.1991)	4.1979 (6.3612)	4.5033 (6.4741)	-1.5435 (1.3805)	-1.6385 (1.3856)
<i>ED Ownership</i>	0.215 (0.1897)	0.2101 (0.1753)	0.07 (0.0993)	0.0714 (0.0992)	0.0167 (0.0142)	0.017 (0.0143)
<i>NED Ownership</i>	0.2487 (0.2058)	0.2557 (0.2069)	0.1493 (0.1080)	0.1533 (0.1068)	-0.0005 (0.0283)	-0.0005 (0.0284)
<i>Busyness</i>	0.066 (0.1488)	0.098 (0.1491)	0.1453 (0.1177)	0.1557 (0.1214)	-0.0349 (0.0252)	-0.0383 (0.0255)
<i>Interlock</i>	-0.1313 (0.1327)	-0.107 (0.1310)	0.2333 (0.1608)	0.2372 (0.1629)	-0.0398 (0.0470)	-0.04 (0.0472)
Industry	None	None	Yes	Yes	Yes	Yes
Years	Yes	Yes	Yes	Yes	Yes	Yes
Wald's Test	2.26***	2.31***	1.84***	1.86***	1.81	1.59
BPLM Test	27.48***	28.00***	33.78***	34.00***	-	-
LR Test	-	-	-	-	83.66***	82.28***
Hausman Test	63.04***	66.60***	14.66	15.86	-	-
Chi2	1.52*	1.50	103.76***	109.08***	49.82***	50.21***
Appropriate Model	Fixed Effects	Fixed Effects	Random Effects	Random Effects	Random Effects	Random Effects
Observations	651	651	651	651	651	651

Table 10*Panel Estimation Results: Firm Performance and AC Chair That is NSID*

The dependent variable is Firm Performance, as measured by *ROA*, *ROE*, or *NEGPROF*. *ROA* is computed as net income plus interest expenses net of tax effects (*EBIAT*) divided by the book value of assets of the previous period; *ROE* is computed as *EBIAT* divided by the book value of equity of the previous period; *NEGPROF* is a dummy variable equal to 1 when the firm's *EBIAT* is negative and 0 otherwise. *ACNSIDCHAIR* a dummy variable that takes the value of 1 if the audit committee's chair is a non-strict independent director and 0 otherwise; *TopOwn* is the percentage ownership of the largest shareholder; *Firm Size* is the natural logarithm of the book value of total assets; *Growth Opportunities* is proxied by the one-period lagged market-to-book asset ratio; *Leverage* is the ratio of long-term debt to total assets; *Firm Age* is the natural logarithm of the number of years since the firm's date of incorporation; *CEO Duality* is a dummy variable that takes on the value of 1 when the CEO is also the Chair of the board and 0 otherwise; *ED Proportion* is the proportion of executive directors on the board; *Board Size* is the natural logarithm of the number of directors on the board; *EDown* is the percentage of outstanding shares owned by executive directors; *NEDown* is the percentage of outstanding shares owned by non-executive directors; *Busyness* is the ratio of the number of busy non-executive directors to board size; *Interlock* is measured as the ratio of the number of interlocked executive directors to board size. The test statistics of the various specification tests are also reported. BPLM test is the Breusch-Pagan Lagrange Multiplier used to test for random effects; Wald's test is used to examine whether there are fixed effects; Hausman test is used to determine whether the random effects model suffers from biased and inconsistent estimates; LR Test is analogous to the BPLM test but for logistic regressions. The results of these tests indicate that the Fixed Effects model is appropriate for regression models 1 to 4, while the random effects logistic model is appropriate for models 5 and 6. The coefficient estimates for columns 5 and 6 are the average marginal effects. Figures in parentheses are cluster-robust standard errors. *** denotes significance at the 1% level; ** denotes significance at the 5% level; and * denotes significance at the 10% level.

Dependent Variable	ROA		ROE		NEGPROF	
Variable	1	2	3	4	5	6
<i>ACNSIDCHAIR</i>	-5.9294*	-11.7076*	-1.0778	-0.5722	-0.505	-0.205
	(3.1954)	(6.0573)	(2.5871)	(6.2038)	(0.4833)	(1.0789)
<i>TopOwn</i>	0.1194	0.0789	-0.0223	-0.0172	-0.0047	-0.0017
	(0.1019)	(0.1034)	(0.0567)	(0.0775)	(0.0126)	(0.0157)
<i>ACNSIDCHAIRS x TopOwn</i>		0.1059		-0.0094		-0.006
		(0.0951)		(0.0931)		(0.0194)
<i>Firm Size</i>	-2.0016	-2.0184	2.1981***	2.1937***	-0.8898***	-0.8915***
	(1.5815)	(1.5833)	(0.7795)	(0.7740)	(0.1824)	(0.1826)
<i>Growth Opportunities</i>	4.6085	4.5828	-0.1162	-0.1103	0.4185*	0.4208*
	(3.1685)	(3.1512)	(2.3723)	(2.3693)	(0.2173)	(0.2173)
<i>Leverage</i>	0.1872*	0.177	0.0972	0.0974	-0.0135	-0.0131
	(0.1090)	(0.1134)	(0.1179)	(0.1176)	(0.0176)	(0.0176)
<i>Firm Age</i>	3.071	2.2024	0.6481	0.6525	-0.1943	-0.188
	(9.2678)	(9.0718)	(1.7304)	(1.7202)	(0.4185)	(0.4186)
<i>CEO Duality</i>	-4.9425	-4.4879	-4.7477	-4.759	0.8913	0.886
	(4.6257)	(4.6963)	(3.0753)	(3.0733)	(0.5697)	(0.5697)

<i>ED Proportion</i>	0.0844 (0.1047)	0.0877 (0.1075)	0.1365 (0.0877)	0.1369 (0.0864)	-0.0386** (0.0179)	-0.0384** (0.0180)
<i>Board Size</i>	-11.6929 (18.3032)	-11.9646 (18.6823)	5.3894 (6.7514)	5.3696 (6.7799)	-1.7074 (1.4256)	-1.7208 (1.4247)
<i>ED Ownership</i>	0.2162 (0.1740)	0.2104 (0.1700)	0.0711 (0.0987)	0.0713 (0.0986)	0.0181 (0.0139)	0.0183 (0.0139)
<i>NED Ownership</i>	0.2939 (0.2137)	0.2844 (0.2142)	0.1547 (0.1136)	0.1547 (0.1139)	0.0044 (0.0281)	0.0046 (0.0282)
<i>Busyness</i>	0.0842 (0.1500)	0.0939 (0.1502)	0.2089* (0.1219)	0.2086* (0.1229)	-0.0402 (0.0260)	-0.0406 (0.0261)
<i>Interlock</i>	-0.1018 (0.1233)	-0.0951 (0.1247)	0.2483 (0.1601)	0.2485 (0.1605)	-0.0493 (0.0488)	-0.0487 (0.0487)
Industry	None	None	Yes	Yes	Yes	Yes
Years	Yes	Yes	Yes	Yes	Yes	Yes
Wald's Test	2.26***	2.26***	2.09***	1.91***	1.23	0.72
BPLM Test	35.67***	35.92***	36.63***	36.63***	-	-
LR Test	-	-	-	-	81.10***	80.58***
Hausman Test	56.87***	57.40***	15.48	15.51	-	-
Chi2	1.51	1.42	100.99***	108.52***	48.40***	48.37***
Appropriate Model	Fixed Effects	Fixed Effects	Random Effects	Random Effects	Random Effects	Random Effects
Observations	640	640	640	640	640	640

We further investigate the impact of non-strict independent directors on firm performance through their role in the audit committee in Model 3. Results of estimating Model 3 are shown in Tables 9 and 10. Table 9 reports the results when the proportion of non-strict independent directors in the audit committee is the independent variable of interest while Table 10 reports the effect of non-strict independent audit committee chairs on firm performance.

Results in columns 1 and 2 of Table 9 indicate that the proportion of non-strict independent directors in the audit committee is negatively related to firm performance. These findings support the agency theory, which posits that non-strict independent directors are appointed not to enhance firm value through proper board oversight and monitoring, but to create an environment that is friendlier towards management, which leads to lower performance. Results in Table 10 point to a similar inference. Specifically, there is some evidence that if the audit committee chair is a non-strict independent director, then firm performance is lower, similar to the findings of Crespi-Cladera and Pascual-Fuster (2014).

However, an examination of the interaction term between ownership concentration and the proportion of non-strict independent directors in the audit committee in Table 9 shows that this coefficient is positive and statistically significant. Thus, although a higher proportion of non-strict independent directors in the audit committee negatively affects firm performance, this negative effect is lower for firms with high ownership concentration, similar to our findings from estimating Model 2. Taken together, these results seem to suggest that while the presence of non-strict independent directors in the audit committee may be indicative of some form of agency problem among firms with a dispersed ownership structure, the same cannot be said for firms with higher ownership concentration, which characterizes most Philippine publicly listed firms.

Conclusion and Recommendations

Board independence is an important topic in the corporate governance literature because of the supposed benefits it confers to both the shareholders and the firm. Independent directors are meant to provide industry expertise and experience to less experienced board members and managers, and they ideally protect minority shareholders from wealth expropriation by either management or large shareholders. However, among Philippine publicly listed firms, we find that an average of 50.99% of independent director positions are occupied by non-strict independent directors, and that 50.48% of the individuals who are declared independent directors are non-strict independent directors. This makes it more likely for board independence to be an ineffective corporate governance mechanism for preventing wealth expropriation by management or large shareholders.

Using an unbalanced panel of 926 firm-years for the period 2012 to 2015, we find significant evidence that firms with concentrated ownership are more likely to have a non-strict independent director on the board. Moreover, using an unbalanced panel of 669 firm-years for the period 2012 to 2015, we find that the proportion of non-strict independent directors has an insignificant effect on firm performance, regardless of the firm performance measure used. These results indicate that publicly listed firms with concentrated ownership in the Philippines do not appoint non-strict independent directors to mask some agency problem but to satisfy regulatory requirements while achieving the optimal level of board independence, consistent with the optimal board independence theory.

We further investigate the impact of non-strict independent directors on firm performance through their role in the audit committee and find that the presence of these directors in the audit committee erodes firm value, which supports the agency theory. However, we also find evidence

that this negative effect on performance is mitigated for firms with higher ownership concentration. This leads us to conclude that firms with higher ownership concentration do not appoint non-strict independent directors to mask agency problems present in the firm; rather, their presence gives management some degree of flexibility to effectively govern the firm. Overall, we find some evidence in support of the optimal board independence theory for firms with higher ownership concentration. On the other hand, for firms with lower ownership concentration, non-strict independent directors erode firm value not through their presence on the board but through their involvement in the audit committee.

While our results suggest that the proportion of non-strict independent directors does not negatively affect firm performance, the case where independent directors are not strictly independent still exposes minority shareholders to the risk of wealth expropriation. Given that about half of the declared independent directors in Philippine publicly traded firms are not strictly independent, then the effectiveness of board independence as a corporate governance mechanism to protect the interests of minority shareholders is diluted. While the 2017 Philippine Code of Corporate Governance for Publicly Listed Firms requires firms to have policies on minority shareholder rights and privileges, the Code leaves the formulation of such policies to the firm.

Fortunately, the Corporation Code of the Philippines (Abrugrar, 2012) provides some degree of power for minority shareholders to ensure their representation on the board. The Corporation Code mandates that shareholders may cumulate their votes to increase the chances of their desired director being appointed and that directors who fulfill the right to representation of shareholders may not be removed without cause (Batas Pambansa Blg 68 - The Corporation

Code of the Philippines, 1980).¹⁷ Minority shareholders who band together to cumulate¹⁸ their shares increase their chances of board representation (Bhagat & Brickley, 1984); however, the effectivity of this practice depends on the degree of ownership concentration of the majority owners. On November 2017, the Securities and Exchange Commission of the Philippines raised the minimum required public float of listed companies to 20% from 10% for new entrants into the stock market with plans to gradually increase the public float of currently listed companies in the following years (Francia, 2017).¹⁹ This improves the chances that minority shareholders who cooperate will have legitimate representation in board matters. However, while this new requirement increases the chances of minority representation, the minority shareholders' interest may still have little influence over board matters due to the number of directors who may be allied to the largest shareholders.

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¹⁷ See Section 24 of the Corporation Code of the Philippines.

¹⁸ A cumulative voting system gives shareholders the option to accumulate their votes across the number of directors to be elected and put it towards electing their representative director. Bhagat and Brickley (1984) presented a formula to ensure representation based on the number of directors a shareholder or a group of shareholders wants to elect and the corresponding number of shares needed to do so.

¹⁹ Also, see SEC Memorandum Circular No. 13 Series of 2017, dated December 1, 2017.

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Appendices

Appendix A: Evolution of Corporate Governance Codes in the Philippines

The first Code of Corporate Governance in the Philippines that was promulgated by the Securities and Exchange Commission (SEC) in 2002 defined an independent director is as follows (taken verbatim from SEC Memorandum No 16 Series of 2002, dated April 5, 2002, except for item g):

List A.1 – 2002 Code of Corporate Governance:

- a. *Is not a director or officer or substantial stockholder of the corporation or of its related companies or any of its substantial shareholders (other than as an independent director of any of the foregoing)*
- b. *Is not a relative of any director, officer or substantial shareholder of the corporation, any of its related companies or any of its substantial shareholders. For this purpose, relatives include spouse, parent, child, brother, sister, and the spouse of such child, brother or sister;*
- c. *Is not acting as a nominee or representative of a substantial shareholder of the corporation, any of its related companies or any of its substantial shareholders;*
- d. *Has not been employed in any executive capacity by that public company, any of its related companies or by any of its substantial shareholders within the last five (5) years;*
- e. *Is not retained as professional adviser by that public company, any of its related companies or any of its substantial shareholders within the last five (5) years, either personally or through his firm;*
- f. *Has not engaged and does not engage in any transaction with the corporation or with any of its related companies or with any of its substantial shareholders, whether by himself or with other persons or through a firm of which he is a partner or a company of which he is a director or substantial shareholder, other than transactions which are conducted at arm's length and are immaterial or insignificant.*
- g. *Must not have beneficial security ownership of more than 10 percent of the company's outstanding shares.*

The Code was revised in 2009 via SEC Memorandum No. 6 Series of 2009, dated June 22, 2009, and stipulated that independent directors may only own up to two% of the subscribed capital stock of the company covered by the Code or its subsidiaries and affiliates. In a subsequent memorandum (SEC Memorandum Circular No. 9 Series of 2009, dated June 24, 2009), the SEC included two additional criteria that independent directors must satisfy.

List A.2 – 2009 Revised Code of Corporate Governance:

- a. *A regular director who resigns or whose term ends on the day of the election shall only qualify for nomination and election as an Independent director after a two (2) year “cooling-off period”;*
- b. *Persons appointed as Chairman “Emeritus”, “Ex-Officio” Directors/Officers or Members of may Executive Advisory Board, or otherwise appointed in a capacity to assist the Board in the performance of its duties and responsibilities shall be subject to a one (1) year “cooling-off period” prior to his qualification as an Independent directors.*
- c. *Must not have beneficial equity ownership of more than two percent of the subscribed capital stock of the covered company or its subsidiaries.*

In 2011, the SEC introduced the following term limits for independent directors of all listed, public, and mutual fund companies (taken verbatim from SEC Memorandum Circular No. 9 Series of 2011, dated December 5, 2011:

List A.3 – 2011 Amendments to the 2009 Revised Corporate Governance Code:

- a. *There shall be no limit in the number of covered companies that a person may be elected as Independent director (ID), except in business conglomerates where an ID can be elected to only five (5) companies of the conglomerate, i.e., parent company, subsidiary or affiliate;*
- b. *IDs can serve as such for five (5) consecutive years, provided that service for a period of at least six (6) months shall be equivalent to one (1) year, regardless of the manner by which the ID position was relinquished or terminated;*
- c. *After completion of the five-year service period, an ID shall be ineligible for election as such in the same company unless the ID has undergone a “cooling off” period of two (2) years, provided, that during such period, the ID concerned has not engaged in any activity that under existing rules disqualifies a person from being elected as ID in the same company;*
- d. *After service as ID for ten (10) years, the ID shall be perpetually barred from being elected as such in the same company, without prejudice to being elected as ID in other companies outside of the business conglomerate, where applicable, under the same conditions provided for in this Circular;*

On November 26, 2016, the Code of Corporate Governance Code for Publicly Listed Companies was promulgated by the SEC. This new code applies only to publicly listed companies in the Philippines and took effect on January 1, 2017. It consolidates the criteria for independent directors from the 2009 Revised Code of Corporate Governance (as amended) and introduces a number of new criteria. The criteria for independence are as follows (items *a* to *j* are taken verbatim from the SEC Memorandum No. 19 Series of 2016, dated November 22, 2016, while item *g* is from SEC Memorandum No. 4 Series of 2017, dated March 9, 2017):

List A.4 – 2017 Code of Corporate Governance for Publicly Listed Companies

- a. *Is not, or has not been a senior officer or employee of the covered company unless there has been a change in the controlling ownership of the company;*
- b. *Is not, and has not been in the company three years immediately preceding the election, a director of the covered company; a director, officer, employee of the covered company’s subsidiaries, associates, affiliates or related company’s subsidiaries, associates, affiliates or related companies; or a director, officer, employee of the covered company’s substantial shareholders and its related companies;*
- c. *Has not been appointed in the covered company, its subsidiaries, associates, affiliates or related companies as Chairman “Emeritus,” “Ex-Officio” Directors/Officers or Members of any Advisory Board, or otherwise appointed in a capacity to assist the Board in the performance of its duties and responsibilities within three years immediately preceding his election;*
- d. *Is not an owner of more than two percent of the outstanding shares of the covered company, its subsidiaries, associates, affiliates or related companies;*
- e. *Is not a relative of a director, officer, or substantial shareholder of the covered company or any of its related companies or of any of its substantial shareholders. For this*

- purpose, relatives include spouse, parent, child, brother, sister, and the spouse of such child, brother or sister;
- f. Is not acting as a nominee or representative of any director of the covered company or any of its related broker-dealer” refers to any person holding any office of trust and responsibility in a broker-dealer firm, which includes among others, a director, officer, principal stockholder, nominee of the firm to the Exchange, an associated person or salesman, and an authorized clerk of the broker or dealer;
 - g. Is not retained, either in his personal capacity or through a firm, as a professional adviser, auditor, consultant, agent or counsel of the covered company, and of its related companies or substantial shareholder, or is otherwise independent of Management and free from any business or other relationship within the three years immediately preceding the date of his election;
 - h. Does not engage or has not engaged, whether by himself or with other persons or through a firm of which he is a partner, director or substantial shareholder, in any transaction with the covered company or any of its related companies or substantial shareholders, other than such transactions that are conducted at arm’s length and could not materially interfere with or influence the exercise of his independent judgement;
 - i. Is not affiliated with any non-profit organization that receives significant funding from the covered company or any of its related companies or substantial shareholders; and
 - j. Is not employed as an executive officer of another company where any of the covered company’s executives serve as directors.
 - k. Others: Cumulative of serving up to 9 years and can never be classified as an independent director thereafter.

Table A summarizes the overlapping and new criteria between the 2002 and 2009 Code with the new 2017 Code.

Table A
Board Independent Criteria Across the Years

The 2017 Code column lists criteria from the 2017 Code. Letters in the second to the last column indicate whether that certain criterion has been introduced prior to the new code, and these letters correspond to the older criteria listed in Lists A.1, A.2, and A.3 above.

<i>2017 Code (List A.4)</i>	<i>2011 Memo</i>	<i>2009 Code</i>	<i>2002 Code</i>
<i>Is not, or has not been a senior officer or employee of the covered company unless there has been a change in the controlling ownership of the company</i>	-	-	<i>d</i>
<i>Is not, and has not been in the company three years immediately preceding the election, a director of the covered company; a director, officer, employee of the covered company’s subsidiaries, associates, affiliates or related company’s subsidiaries, associates, affiliates or related companies; or a director, officer, employee of the covered company’s substantial shareholders and its related companies</i>	<i>a and c</i>	<i>a</i>	<i>a and d</i>
<i>Has not been appointed in the covered company, its subsidiaries, associates, affiliates or related companies</i>	-	<i>b</i>	-

<i>as Chairman “Emeritus,” “Ex-Officio” Directors/Officers or Members of any Advisory Board, or otherwise appointed in a capacity to assist the Board in the performance of its duties and responsibilities within three years immediately preceding his election</i>			
<i>Is not an owner of more than two percent of the outstanding shares of the covered company, its subsidiaries, associates, affiliates or related companies</i>	-	c	g
<i>Is not a relative of a director, officer, or substantial shareholder of the covered company or any of its related companies or of any of its substantial shareholders. For this purpose, relatives include spouse, parent, child, brother, sister, and the spouse of such child, brother or sister</i>	-	-	b
<i>Is not acting as a nominee or representative of any director of the covered company or any of its related companies</i>	-	-	c
<i>Is not a securities broker-dealer of listed companies and registered issuers of securities. “Securities broker-dealer” refers to any person holding any office of trust and responsibility in a broker-dealer firm, which includes among others, a director, officer, principal stockholder, nominee of the firm to the Exchange, an associated person or salesman, and an authorized clerk of the broker or dealer</i>	-	-	-
<i>Is not retained, either in his personal capacity or through a firm, as a professional adviser, auditor, consultant, agent or counsel of the covered company, and of its related companies or substantial shareholder, or is otherwise independent of Management and free from any business or other relationship within the three years immediately preceding the date of his election</i>	-	-	e
<i>Does not engage or has not engaged, whether by himself or with other persons or through a firm of which he is a partner, director or substantial shareholder, in any transaction with the covered company or any of its related companies or substantial shareholders, other than such transactions that are conducted at arm’s length and could not material interfere with or influence the exercise of his independent judgement</i>	-	-	f
<i>Is not affiliated with any non-profit organization that receives significant funding from the covered company or any of its related companies or substantial shareholders</i>	-	-	-
<i>Is not employed as an executive officer of another company where any of the covered company’s executives serve as directors</i>	-	-	-

Others: Cumulative of serving up to 9 years and can never be classified as an independent director thereafter	<i>b and d</i>	-	-
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Appendix B: Eight-Point Criteria for Strict Board Independence

The following criteria for non-strict board independence is taken in verbatim from Crespi-Cladera and Pascual-Fuster (2014):

1. *Proposed for appointment or renewal by the nomination committee*
2. *Tenure as independent director for up to twelve years*
3. *Not having a significant business relationship with the company*
4. *Not holding a directorship, to be a manager or an employee of significant shareholder or a shareholder with board representation*
5. *Not having other relevant relationship (different than those in point 4) with significant shareholder or a shareholder with board representation*
6. *Not being a director or executive in subsidiaries or associated companies*
7. *Not to be a company as board director*
8. *Not being executive director of the firm in the previous year*

APPENDIX C:

Table C

Board Independent Criteria Verification

The 2017 Code column lists the independence criteria. The Source/s column indicates the source that is used to verify the criterion in question. Note that ACGR refers to the Annual Corporate Governance Report; AR refers to Annual Report; and POR refers to Public Ownership Report

2017 Code (List A.4)	Source/s
<i>Is not, or has not been a senior officer or employee of the covered company unless there has been a change in the controlling ownership of the company</i>	Part 1 and Part III Item 9 of the AR from 2002 to 2015
<i>Is not, and has not been in the company three years immediately preceding the election, a director of the covered company; a director, officer, employee of the covered company's subsidiaries, associates, affiliates or related company's subsidiaries, associates, affiliates or related companies; or a director, officer, employee of the covered company's substantial shareholders and its related companies</i>	Part III Item 9 of the AR from 2002 to 2015 and section A.1.d of the ACGR
<i>Has not been appointed in the covered company, its subsidiaries, associates, affiliates or related companies as Chairman "Emeritus," "Ex-Officio" Directors/Officers or Members of any Advisory Board, or otherwise appointed in a capacity to assist the Board in the performance of its duties and responsibilities within three years immediately</i>	Section E. of the ACGR and Part III Item 9 of the AR

<i>preceding his election</i>	
<i>Is not an owner of more than two percent of the outstanding shares of the covered company, its subsidiaries, associates, affiliates or related companies</i>	Section A.1.e of the ACGR and Part III Item 11 of the AR
<i>Is not a relative of a director, officer, or substantial shareholder of the covered company or any of its related companies or of any of its substantial shareholders. For this purpose, relatives include spouse, parent, child, brother, sister, and the spouse of such child, brother or sister</i>	Section B.5 of the ACGR
<i>Is not acting as a nominee or representative of any director of the covered company or any of its related companies</i>	Section A.1.a of the ACGR and Part III Item 9 of the AR
<i>Is not a securities broker-dealer of listed companies and registered issuers of securities. "Securities broker-dealer" refers to any person holding any office of trust and responsibility in a broker-dealer firm, which includes among others, a director, officer, principal stockholder, nominee of the firm to the Exchange, an associated person or salesman, and an authorized clerk of the broker or dealer</i>	Part III Item 9 of the AR
<i>Is not retained, either in his personal capacity or through a firm, as a professional adviser, auditor, consultant, agent or counsel of the covered company, and of its related companies or substantial shareholder, or is otherwise independent of Management and free from any business or other relationship within the three years immediately preceding the date of his election</i>	Part III Item 9 and 12 of the AR and Section B.4 of the ACGR
<i>Does not engage or has not engaged, whether by himself or with other persons or through a firm of which he is a partner, director or substantial shareholder, in any transaction with the covered company or any of its related companies or substantial shareholders, other than such transactions that are conducted at arm's length and could not material interfere with or influence the exercise of his independent judgement</i>	Part III Item 9 and 12 of the AR and Section B.4 of the ACGR
<i>Is not affiliated with any non-profit organization that receives significant funding from the covered company or any of its related companies or substantial shareholders</i>	Part III Item 9 and 12 of the AR and Section B.4 and L of the ACGR
<i>Is not employed as an executive officer of another company where any of the covered company's executives serve as directors</i>	Part III Item 9 of the AR and Section A.1.d of the ACGR
<i>Others: Cumulative of serving up to 9 years and can never be classified as an independent director thereafter</i>	Part III Item 9 of the AR from 2002 to 2015

APPENDIX D:
Table D
List and Definitions of Variables

Dependent Variables

Model 1: Presence of Non-Strict Independent directors

Presence of Non-Strict ID (*PNSID*) A dummy variable equal to 1 if there is a NSID on the board, 0 otherwise

Model 2: Firm Performance

Return on Assets (*ROA*)

$$ROA = \frac{EBIAT}{BVA} \times 100$$

EBIAT = Earnings Before Interest, net of taxes
BVA = Previous period's book value of total assets

Return on Equity (*ROE*)

$$ROE = \frac{EBIAT}{BVE} \times 100$$

EBIAT = Earnings before interest, net of taxes
BVE = Previous period's book value of total equity

Negative Profit (*NEGPROF*) A dummy variable equal to 1 if there is a NSID on the board, 0 otherwise

Independent Variables

Variables of Interest

% of Non-Strict Independent Directors (*NSID*)

$$NSID = \frac{NSID}{Board} \times 100$$

NSID = Number of NSID on the board
Board = Number of directors on the board

Presence of Non-Strict Independent Directors in the Audit Committee (*AC*)

$$AC_{NSID} = \frac{NSID_{AC}}{AC} \times 100$$

NSID_{AC} = Number of NSID on the audit committee
AC = Number of directors in the audit committee

AC_{chair} = a dummy variable that takes the value of 1 if the audit

	committee chair is an NSID and 0 otherwise.
Top Ownership (<i>Top</i>)	Percentage of common shares outstanding owned by the largest shareholder
<i>Firm-level Control Variables</i>	
Firm Size (<i>Fsize</i>)	$Fsize = \ln(BVA)$ $BVA = \text{Book value of total assets}$
Growth Opportunities (<i>Fgrowth</i>)	$Fgrowth = \ln\left(\frac{MCE + BPE + TD - DTL}{BVA}\right)$ $MCE = \text{Market value of common equity}$ $BPE = \text{Book value of preferred equity}$ $TD = \text{Book value of total debt}$ $DTL = \text{Book value of deferred tax liabilities}$ $BVA = \text{Book value of total assets}$
Firm Leverage (<i>Flev</i>)	$Flev = \frac{LTD}{BVA} \times 100$ $LTD = \text{Long term debt}$ $BVA = \text{Book value of total assets}$
Firm Age (<i>Fage</i>)	$\ln(\text{Number of years since incorporation})$
<i>Corporate Governance Variables</i>	
CEO Duality (<i>Dual</i>)	$Dual = \begin{cases} 1 & \text{if CEO is Chair of the board} \\ 0 & \text{otherwise} \end{cases}$
Proportion of ED (<i>ED</i>)	$ED = \frac{\text{Number of ED}}{\text{Board}} \times 100$ $\text{Number of ED} = \text{Number of executive directors}$ $\text{Board} = \text{Number of directors on the board}$
Board Size (<i>Bsize</i>)	$\ln(\text{Number of directors on the board})$
ED Ownership (<i>EDown</i>)	Sum of the percentage ownership of all executive directors

NED Ownership
(*NEDown*)

Sum of the percentage ownership of all non-executive directors

$$Busy = \frac{Busyness}{Board} \times 100$$

Board Busyness
(*Busy*)

Busyness = Number of non-executive directors
with 3 or more directorships
in their portfolio

Board = Number of directors on the board

Interlocking
Directorates
(*Interlock*)

$$Interlock = \frac{Interlocking}{Board} \times 100$$

Interlocking = Number of executive directors
with interlocking directorships

Board = Number of directors on the board
