

ABSTRACT

1. Introduction

1.1 Corporate Governance: The Emergence and Exigency in South Asia

While the expression ‘corporate governance’ (CG) first appeared in the United States Federal Register in 1976, the underlying ideas have attracted scholars for decades. However, the focus on CG evolved more recently in Asia, owing to the 1997 financial crisis (Claessens & Fan, 2002). The crisis sparked a wave of CG reforms across the continent, which has resulted in an increase in relevant research in subsequent years. In terms of CG, the economies of South Asia trail behind those of other areas. This vulnerability is caused by family-run firms' concentrated ownership and a fragile regulatory framework with high corruption and little transparency (Shirodkar et al., 2016). Despite these difficulties, current initiatives in South Asia to enhance CG frameworks present encouraging directions for further study.

1.2 Audit Quality, Board Diversity and Firm Performance: A Tapestry of Governance

Several prominent theories provide light on the link between CG and FP. Jensen and Meckling (1976) pioneered agency theory, which considers CG as a method to ameliorate agency difficulties caused by the separation of ownership and control. It focuses on holding managers accountable for their actions and discouraging possible wrongdoing with proper incentives and sanctions. Freeman's (1984) stakeholder theory takes a larger view, arguing for managerial consideration of all stakeholders' interests. This idea contends that meeting the requirements of numerous stakeholders improves long-term corporate success. Williamson (1985) introduced transaction cost theory, which focuses on firms' internal governance structures. It proposes that firms set up CG mechanisms to reduce transaction costs linked with contracting and resource allocation, hence increasing value creation. Pfeffer and Salancik (1978) established resource dependency theory, which emphasises the influence of external resources on FP. It implies that directors, through their external networks, may acquire essential resources for the firm, thereby contributing to its financial success. These theoretical perspectives provide a rich foundation for analysing the intricate interaction between CG practices with FP. Despite their differing viewpoints (internal vs. external), these theories agree that CG is vital for a firm's efficient functioning. As a consequence, scholars have extensively investigated the CG-FP relationship, with an emphasis on critical aspects such as audit quality (AQ) and board

diversity (BD) (Tabassam & Khan, 2021). Based on agency theory, AQ acts as an external monitoring mechanism (Matoke & Omwenga, 2016), whereas BD operates as an internal governance structure (Terjesen et al., 2016).

AQ is defined by DeAngelo (1981) as the expectation that an auditor will find and disclose misstatements. It means that auditor should detect material misstatements and report these material misstatements which then reflect his competence and independence which are the two elements that sum up AQ. In all cases, the auditor earns the trust of society by providing accurate and high performing AQ to confirm the reliability and transparency of financial statements. AQ is thus that apparatus which plays an indispensable role in mitigating asymmetries in information and reinforces confidence in the stakeholders (Matoke & Omwenga, 2016). Being the essence of a sound equity market, AQ proportionately encourages strong CG functioning resulting in potential positive influences on the FP (Al Ani & Mohammed, 2015).

Board of directors is elemental in running an organization efficiently as it provides a strategic focus and influences the FP (Srivastava, 2015). Highlighting the exigency of diversity in boards, the 2014 UK CG Code posits that BD can bring onboard constructive debate drawing upon its prismatic nature. Defined as the diverseness in the board's composition (Kagzi & Guha, 2018), BD is an admixture of demographic and structural diversity. Researchers are of the opinion that while diverse boards may face challenges such as interpersonal conflicts and communication barriers (Cox, Jr., 1991), they can also offer significant advantages. These include the potential for broader perspectives in decision-making, enhanced creativity and innovation (Veltrop et al., 2015). Nevertheless, following the aftermath of the global financial havoc, regulators and researchers across the continents have acknowledged the necessity for legislation to modify the composition of boards of directors thereby making research in this domain a pressing priority (Baker et al., 2020).

This study is an attempt to enrich the existing body of literature by exploring the different dimensions of both the internal and external wings of CG via the means of a cross-country analysis in the relatively underexplored SAARC (South Asian Association of Regional Cooperation) nations. Figure 1.1 illustrates the broad framework developed for the present study.

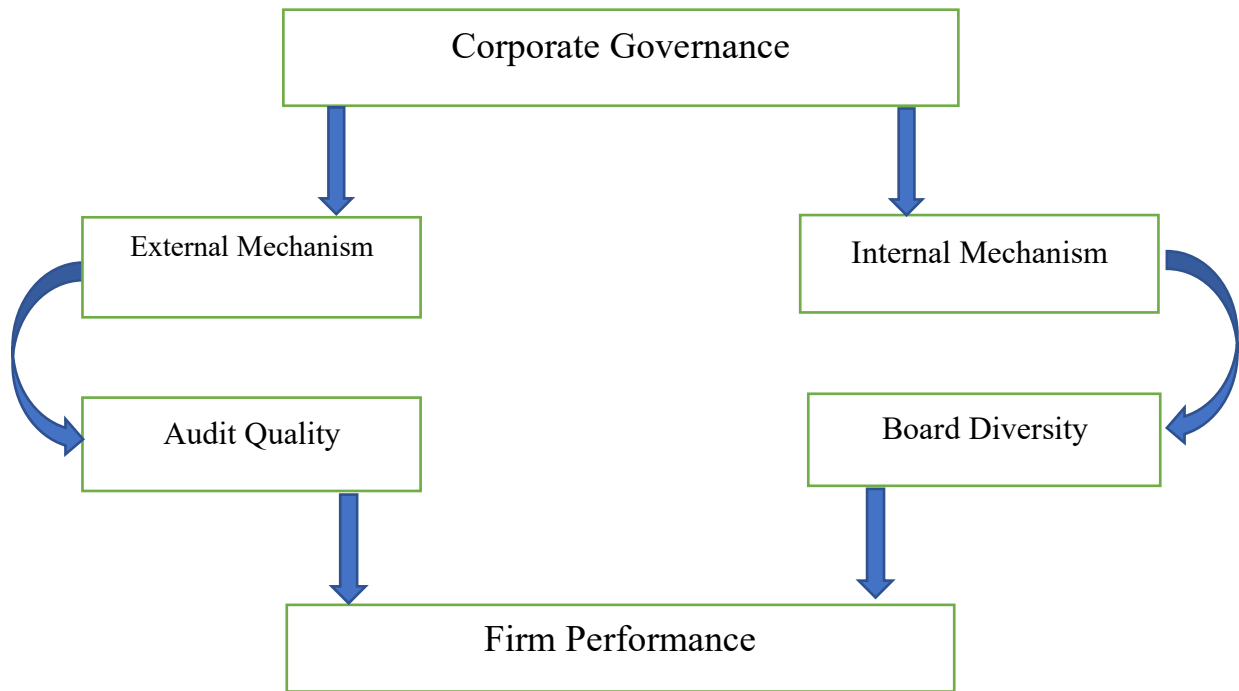


Figure 1: Broad Framework of the Study

Source: Author's Design

1.3 Research Gaps: Unveiling the Unexamined Territories

Deriving from the paucities in the extant literature several research gaps have been identified:

- i) The relative meagreness of exploration on CG in the South Asian nations is elemental in spearheading this study. However, with the South Asian region continuing to be the fastest growing sub-region across the globe, research focussed in the region has become the need of the hour (Kirchmaier & Gerner-Beuerle, 2021).
- ii) Second, the capital markets in SAARC nations are categorized by concentrated ownership pattern, restricted transparency, and long-term perspective (Ho & Kang, 2013). This study aims to bridge this gap by documenting empirical evidence of the impact of AQ and BD on FP while accounting for these peculiarities.
- iii) Third, while most research on the AQ-FP nexus focuses on industrialised countries and "principal-agent" concerns; emerging countries, such as SAARC members, present unique challenges due to "principal-principal" dynamics.

The less robust institutional and legal safeguards for minority owners, which are more common in the nations under study, exacerbate the agency conflict between large and small shareholders making AQ study *prima facie* imperative (Bhatt & Bhattacharya, 2015).

- iv) Fourth, the audit market in the SAARC region being dominated by BIG4, along with the region's comparatively lower litigation risk, create an atmosphere conducive to complacency, and even collusion or anti-competitive behaviours, further undermining faith in the audit process (Ratzinger-Sakel et al., 2013). These considerations need a more in-depth investigation of the influence of AQ on FP, with auditor size serving as a proxy for AQ. This type of investigation is critical for informing the establishment and implementation of effective audit market sanctions and regulatory policies in the SAARC area.
- v) Fifth, research on BD as a core device of CG has been in practice for the past 40 years (Lynn, 2009). However, the mixed evidences garnered from the extant literature warrants the need of further delving into this area of research (Aggarwal et al., 2019). Furthermore, BD has been widely explored in the context of its demographic diversity, especially, gender diversity whilst the structural diversity of the board along with the other attributes of demographic diversity remains relatively less explored. This study attempts to fill this void by documenting the association of both demographic and structural diversity of the board with the FP.
- vi) Finally, there is a dearth of studies employing cross-country longitudinal data to examine the impact of AQ (Al-Matari et al., 2017) and BD (Kagzi & Guha, 2018) on the FP of firms, specifically in the South Asian context. This study posits to address this lacuna in the existing literature.

2. Objectives

- i) To examine the association between audit quality and firm performance;
- ii) To investigate the relationship between board diversity and firm performance;
and
- iii) To make a comparative study of the effect of audit quality and board diversity on the firm performance among the SAARC countries.

3. Literature Review

3.1 AQ and FP

Established theories allude to a favourable influence of AQ on FP. Agency, stewardship, and stakeholder theories all emphasise how high AQ reduces information asymmetry and encourages responsible management, benefitting both investors and the business (Jensen & Meckling, 1976; Davis et al., 1997; Freeman, 1984). According to signalling theory, high AQ implies a commitment to transparency, which attracts investors (Watts and Zimmerman, 1986). According to resource dependency theory, directors can use high AQ to obtain more important resources. Finally, contingency theory recognises the possible moderating role of contextual elements (Watts & Zimmerman, 1978). Within a CG framework, these theories support AQ's position as an external monitoring mechanism that may be potentially related to value creation (DeFond & Francis, 2005).

Owing to the high degree of dissimilitude concerning the definition of AQ, numerous researchers have employed many AQ proxies to tap its association with FP resulting in heterogeneous evidence with audit fees (AF) and auditor size (BIG4) topping the chart of AQ proxies (Knechel, 2012). Employing AF as the proxy for AQ, Sattar et al. (2020) have attested a significant positive association between AQ and FP. They postulate that a higher fee paid to auditors results in greater audit effort, which is symbolic of an efficient and high-quality audit and ultimately translates into sound FP. However, refuting these Moutinho (2012) argues that increases (decreases) in operating performance are linked to decreases (increases) in AF. Again, another substantial thread of researchers widely holds that AQ is a function of the audit firm's size (Knechel, 2012). Many studies have employed auditor's size as a proxy for AQ. The FP has at numerous times been seen to be greatly improved and enhanced by the presence of a strong, experienced, and competent external auditor (Al-Ahdal & Hashim, 2021). However, the above findings do not hold true for all cases.

Thus, building on the dissension of the theoretical and empirical evidence, this study intends to test the following alternative hypothesis and contribute to a better understanding of the AQ-FP link in emerging countries:

H₁: There exists a significant association between AQ and FP.

3.2 BD and FP

Various viewpoints on efficient board procedures are provided by CG theories. Agency theory places a strong emphasis on impartial boards that protect the interests of shareholders and assess financial performance (Musa & Ibrahim, 2022). Resource

dependency theory underlines the board's external linkages and resource acquisition responsibility, whereas stewardship theory encourages empowered management (Pfeffer & Salancik, 1978). Stakeholder theory promotes considering all relevant parties, and upper echelons theory contends that diversity on a board improves knowledge, FP, and strategic thinking (Hsu et al., 2019). In conclusion, all theories concur that for the optimal FP, the board's and shareholders' interests must align. (Wellalage & Locke, 2013).

Several researchers believe in the notion that BD influence the functioning of the firm which in turn affects the overall FP (Aggarwal et al., 2019). To add to it, Hillman and Dalziel (2003) state that the board also performs the 'resource dependence role' by facilitating the resource requirements of the firm and enhancing the FP. Servicing these roles however does not come without any cost. The heterogeneity in the board may at times create friction which in turn may have devastating effect on the FP. Hambrick et al. (1996) had also backed this proposition by asserting that a homogeneous group of directors take prompt actions and perform more efficiently than a heterogeneous compeer. Thus, albeit the 'double-edged sword' of BD houses prolific literature, it fails to arrive at any denouement (Aggarwal et al., 2019).

Dwelling on the propositions from the various theoretical and empirical evidences, the following hypothesis is developed to test the association between BD and FP:

H₂: There exists a significant association between BD and FP.

Furthermore, the following hypotheses are developed to test the individual effects of the BD attributes on FP:

H_{2a}: There exists a significant association between CEO duality and FP.

H_{2b}: There exists a significant association between board independence and FP.

H_{2c}: There exists a significant association between board gender diversity and FP.

H_{2d}: There exists a significant association between board nationality and FP.

H_{2e}: There exists a significant association between board education and FP.

H_{2f}: There exists a significant association between board age and FP.

4. Methodologies/Approaches applied

Figure 2 illustrates the sequential steps of research methodology followed to achieve the undertaken objectives.

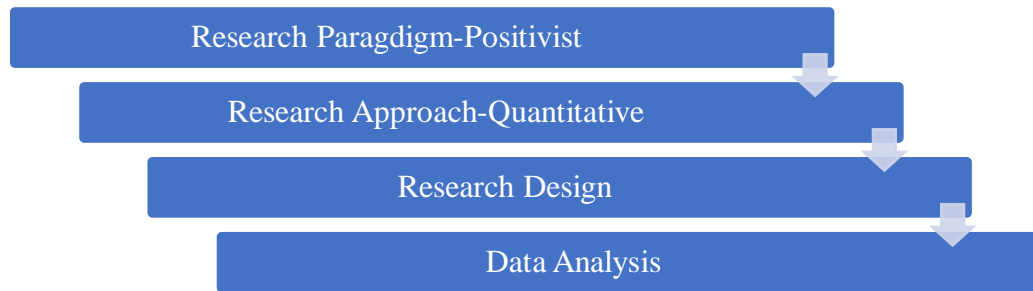


Figure 2: Steps of Research Methodology

Source: Author's Composition

4.1 Research Paradigm

The paradigm used in this research is positivist.

4.2 Research Approach

For this study a quantitative approach has been used.

4.3 Research Design

This study adopts a quantitative approach, utilising secondary data within an experimental research design framework. Figure 3 outlays the categorization of the steps involved in the research design.



Figure 3: Steps Involved in the Research Design

Source: Author's Composition

4.3.1 Variables and Their Measurements

In this sub-section, the variables of interest along with their source of data have been presented.

Table 1: Variables and Their Measurements for Investigating the AQ-FP Association

Variables	Measure	Studies	Source
Dependent Variables			
Return on assets (ROA)	Measured as net income by total assets	Sayyar et al. (2015); Sattar et al. (2020)	Koyfin database
Tobin's Q (TQ)	Measured as the sum of market capitalization and book value of total debt divided by book value of total assets.	Kagzi and Guha (2018); Aggarwal et al. (2019)	Koyfin database
Independent Variables			
Audit fees (AF)	Total AF divided by the square root of the total assets	Simunic (2003); Sattar et al. (2020)	Annual Reports
BIG4	A dummy variable which will have a value of one if the auditing firm is Big 4; otherwise, zero.	Tanko and Polycarp, (2019); Khan et al., (2021)	Annual Reports
Control Variables			
Audit Committee size (ACS)	Measured as the number of members in the audit committee	Bansal and Sharma (2016); Ogbodo and Akabuogu (2018)	Annual Reports
Audit Committee independence (ACI)	Measured as a percentage of independent directors in the audit committee	Bansal and Sharma (2016); Ogbodo and Akabuogu (2018)	Annual Reports
Frequency of audit committee meetings (ACM)	Measured as the total number of meetings held by the audit committee in a year	Bansal and Sharma (2016); Ogbodo and Akabuogu (2018)	Annual Reports
Firm size (FS)	Measured as the natural log of total assets of the firm.	Sayyar et al. (2015); Khan et al., (2021)	Koyfin Database
Firm age (FA)	Measured as the natural log of the number of the years since firm establishment	Fooladi and Shukor (2012); Aggarwal et al. (2019)	Annual Reports
Leverage (LEV)	Measured as the proportion of debts to total assets.	Sayyar et al. (2015); Ogbodo and Akabuogu (2018)	Koyfin Database
Gross Domestic Product (GDP)	Measured as natural logarithm of GDP per capita.	Gunn et al. (2019)	World Development Index
Corruption	Corruption perception index	Martins et al. (2020)	Transparency International

Source: Author's Compilation

Table 2: Variables and Their Measurements to Investigate BD-FP Association

Dependent variables			
Same as defined in table 1			
Variable	Measure	Studies	Source
Independent Variables			
Gender	Measured by the Blau index value for gender diversity (gender is 1, if the board member is female; 0, otherwise)	Kagzi and Guha (2018); Aggarwal et al. (2019);	Annual reports
Education	Measured using Blau index with two categories, viz., ‘financial expertise’ and ‘non-financial expertise’	Kagzi and Guha (2018); Aggarwal et al. (2019)	Annual reports
Age	Measured by Blau index with four categories, viz., ‘20-40’, ‘41-60’, ‘61-80’. ‘80 and above’	Kagzi and Guha (2018); Ozdemir (2020)	Annual reports
Nationality	Measured using Blau index (nationality is 1 if the board member is a foreign national; 0 otherwise)	Miller and Triana, (2009); Frijns et al. (2016)	Annual reports
Director’s independence	Blau index value for structural diversity (independence is 1, if the board member is independent, as reported by the company in its annual report; 0, otherwise)	Ararat et al. (2015); Aggarwal et al. (2019)	Annual reports
CEO duality	Measured as a dummy variable that takes the value 1 if one person occupies the position of CEO and board chair and 0 otherwise.	Aggarwal et al. (2019); Dupatti et al. (2019)	Annual reports
Firm-specific Control Variables			
Board Size (BS)	Measured as the total number of directors on the board of a firm	Kagzi and Guha (2018); Aggarwal et al. (2019)	Annual reports
Firm-Specific Control Variables			
LEV	As defined in Table 1		
FS			
FA			
GDP			

Source: Author’s Compilation

To capture the influence of evolving CG frameworks across the included nations, this study employs a dummy variable which takes a value of one in any year where a CG reform was implemented in the specific country under examination; otherwise, zero. Year fixed effects are also incorporated.

4.3.2 Sample Selection and Data Collection

The listed non-financial enterprises of the member countries of SAARC make up the population of the study. Financial firms are excluded because of the variations in the financial sector rules across the chosen countries. However, among the member nations of SAARC, top 50 firms based on their market capitalization each from the four most prominent nations, namely, Bangladesh, India, Pakistan and Sri Lanka were chosen for the period of 2012-2021. Data accessibility served as a guiding factor for this decision, guaranteeing the robustness of the empirical analysis. The chosen timeframe corresponds to a period of significant regulatory reform in CG among the selected countries. Furthermore, panel data framework is used.

4.3.3 Model Specification

The two-step System Generalized Method of Moment has been used to analyse the dynamic panel data. The following regression models were developed to test our hypotheses:

To examine the association between AQ and FP:

$$\begin{aligned} \pi_{i,t} = & \alpha_i + \delta\mu_{i,t-1} + \beta_1BIG4_{i,t} + \beta_2ACS_{i,t} + \beta_3ACM_{i,t} + \beta_4ACI_{i,t} + \beta_5LEV_{i,t} \\ & + \beta_6FS_{i,t} \\ & + \beta_7FA_{i,t} + \beta_8GDP_{i,t} + \beta_9Corruption_{i,t} + \beta_{10}CG_Reforms_{i,t} \\ & + \beta_{11}Year_{i,t} + \varepsilon_{i,t} \quad \dots (Model 1) \end{aligned}$$

$$\begin{aligned} \pi_{i,t} = & \alpha_i + \delta\mu_{i,t-1} + \beta_1AF_{i,t} + \beta_2ACS_{i,t} + \beta_3ACM_{i,t} + \beta_4ACI_{i,t} + \beta_5LEV_{i,t} + \beta_6FS_{i,t} \\ & + \beta_7FA_{i,t} + \beta_8GDP_{i,t} + \beta_9Corruption_{i,t} + \beta_{10}CG_Reforms_{i,t} \\ & + \beta_{11}Year_{i,t} + \varepsilon_{i,t} \quad \dots (Model 2) \end{aligned}$$

To investigate the relationship between BD FP:

$$\begin{aligned} \pi_{i,t} = & \alpha_i + \delta\mu_{i,t-1} + \beta_1CEO_{i,t} + \beta_2BInd_{i,t} + \beta_3BGen_{i,t} + \beta_4BNat_{i,t} + \beta_5BEdu_{i,t} + \beta_6BAge_{i,t} \\ & + \beta_7BS_{i,t} + \beta_8LEV_{i,t} + \beta_9FS_{i,t} + \beta_{10}FA_{i,t} + \beta_{11}GDP_{i,t} + \beta_{12}CG_Reforms_{i,t} + \beta_{i,t}Year_{i,t} \\ & + \varepsilon_{i,t} \quad \dots (Model 3) \end{aligned}$$

Where $\pi_{i,t}$ is the measure of FP proxied by ROA and TQ respectively for firm i at time t , and $\mu_{i,t-1}$ represents the one-year lag in FP. Again, $\varepsilon_{i,t}$ is the error term.

4.3.4 Robustness Test

The Generalised Estimating Equation population-average model was used for robustness.

5. Results and Discussion

The System GMM model registered the following results as outlined in tables 3 and 4.

Table 3: Results and Discussions Related to Objectives (i) and (ii)

Hypotheses	Result for ROA	Result for TQ
<i>H₁: AQ has a significant association with FP.</i>	Rejected when BIG4 is the proxy of AQ Accepted when AF is the proxy of AQ	Rejected when BIG4 is the proxy of AQ Rejected when AF is the proxy of AQ
<i>H₂: There exists a significant association between BD and FP.</i>	Rejected	Rejected
<i>H_{2a}: There exists a significant association between CEO duality and FP.</i>	Rejected	Rejected
<i>H_{2b}: There exists a significant association between board independence and FP</i>	Accepted	Accepted
<i>H_{2c}: There exists a significant association between board gender diversity and FP</i>	Accepted	Accepted
<i>H_{2d}: There exists a significant association between board nationality and FP.</i>	Rejected	Rejected
<i>H_{2e}: There exists a significant association between board education and FP.</i>	Accepted	Accepted
<i>H_{2f}: There exists a significant association between board age and FP.</i>	Accepted	Accepted

Source: Author's Composition

The results establish that while higher AF is linked with improved ROA, the link with TQ is insignificant, suggesting a potential tipping point where increasing fees yield diminishing returns (Al-Ahdal & Hashim, 2021). Interestingly, the positive relationship between BD and FP is insignificant. This might be due to the relatively recent focus on CG practices in the region. Theories proposing benefits from diversity, such as management networking and efficient monitoring, rely on a robust CG framework that may not be fully established yet (Li et al., 2017).

The findings on specific aspects of board diversity were however mixed. Counter to expectations, CEO duality and board nationality diversity had no significant association with FP. However, both board independence and education diversity were significantly

and negatively linked to FP. This could be due to a lack of training for independent directors, the prevalence of cross-directorships, and social identity theory dynamics within educationally diverse boards (Kagzi & Guha, 2018). Furthermore, the inverse association between board gender diversity and FP derives its rationale from the social identity, social network and the critical mass theories (Khan & Subhan, 2019). Additionally, the select economies are also known for family-owned businesses, where board seats might prioritize family ties over qualifications, potentially diluting the benefits of gender diversity (Chaudhury & Wahid, 2018). In contrast, board age diversity exhibited a positive association with FP, potentially reflecting the benefits of combining experience and new perspectives. Table 4 documents the results of the country-wise analysis of the impacts of AQ and BD on FP.

Table 4: Results of Objective (iii)

Results of the analysis	Bangladesh	India	Pakistan	Sri Lanka
AQ	AF registers a significant positive impact on ROA and a positive but insignificant association with TQ. Again, in case of BIG 4, a significant positive association is attested on both ROA and TQ.	Both the proxies of AQ exerted a positive but insignificant association with both the measures of FP with the association between BIG 4 and TQ being the exception. BIG 4 was observed attesting a significant positive association with TQ.	In the context of Pakistan, it is evident that AQ has a positively significant impact on FP with the impact of AF on TQ being the exception.	BIG4 attested insignificant association with both the measures of FP. AF, however, secured a positive and significant association with TQ while documenting a positive but insignificant association with ROA.
CEO Duality	Negative and insignificant	Positive and insignificant	Positive and insignificant	Positive and significant
Board Independence	Negative significant for accounting profitability	Negative significant for accounting profitability	Negative significant for market-based measure of FP	Negative significant for TQ.
Board Gender Diversity	Negative significant for	Negative significant for	Negative significant for	Negative significant for

	accounting profitability				accounting profitability			
Board Nationality Diversity	Positive significant	and	Negative significant	and	Negative significant	and	Negative for insignificant	and
					market-based measure of FP			
Board Education Diversity	Negative significant	and	Negative for insignificant	and	Negative significant	and	Negative significant for market-based measure of FP	and
Board Age Diversity	Positive significant	and	Positive significant for TQ	and	Positive significant for TQ	and	Positive insignificant.	and
	ROA							

Source: Author's Compilation

The findings highlight some intriguing country-specific variations. While AF generally showed a positive impact on profitability, their link to TQ was less consistent. Interestingly, BIG4, though positive for TQ in some cases, displayed an insignificant overall association with FP. On the BD front, CEO duality did not negatively impact performance, possibly due to mitigating factors like family business ownership (Khan *et al.*, 2021). However, a concerning negative association emerged between independent directors and performance, suggesting a need to improve their effectiveness through training and addressing issues like interlocking directorates. Gender diversity also displayed a negative link across countries, potentially due to challenges with integrating diverse perspectives and the lack of a critical mass (Khan & Subhan, 2019). Board nationality diversity yielded mixed results, with a positive association in Bangladesh but negative in others, suggesting a need to explore the optimal level of foreign directors for each context. Board education displayed a negative link with FP across the nations as observed for the overall results based on the social identity theory dynamics (Kagzi & Guha, 2018). Age diversity albeit inclining towards positive association, presented inconclusive findings against the two FP proxies.

6. Conclusion

This study investigated the relationship between CG and FP in the understudied SAARC area, considering its distinct ownership structures, audit markets, and principal-principal interactions. While audit size exhibited a possible favourable connection with FP, the effect is statistically insignificant. Higher AF increase accounting profitability, but not always

market valuation. BD presents a complex picture, with FP benefitting from age diversity. However, characteristics like as gender, nationality, and education need more stringent screening and an emphasis on qualifications. CEO duality has varying implications based on the ownership structure. Country-specific assessments identify opportunities for improvement in each SAARC country, including audit committee effectiveness and board composition norms. This study fills a knowledge vacuum on CG in SAARC, providing useful insights for policymakers. It offers light on the AQ-FP link in developing economies and investigates the impact of structural BD on FP. This study lays the path for more successful CG practices and improved FP in SAARC nations by emphasising the importance of better enforcement, skilled directors, and regionally customised policies.

7. References

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