Chapter 11
Theoretical Disclosure of Board Independence:
Evidence From Pakistan

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ABSTRACT

In the wake of corporate scandals in major companies like Enron, Tyco, and East Asian crisis have emphasized the need of sufficient number of independent directors on the board for proper oversight and functioning of the company. Code of corporate governance recommends the presence of independent directors for better performance of the company. As board independence ensured good corporate governance practices, it is considered that having independent directors on the board is not for better performance but for better governance. In seeking reasonable answer for these arguments, the purpose of this study is to review some of the literature of board independence with respect to corporate governance theories specifically agency theory, stewardship, and resource dependency theory. All these theories have provided mixed evidences in different studies about the impact and importance of board independence and reason behind these mixed evidences might be the institutional context of different organizations in different countries.

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INTRODUCTION / BACKGROUND OF THE STUDY

In recent years, world governance practices have changed significantly. Revisions in corporate governance codes and shareholders engagement practices in the organization all have contributed to the new standards of governance for developed and developing economies. Change in the standards remains robust, because market is continuously reassessing the guidelines to further improve the governance code of conduct (Aifuwa & Embele, 2019). Corporate scandals of major companies like Enron, WorldCom and Tyco, along with that East Asian crisis gave rise to the concern about monitoring and effectiveness of the board. These scandals emphasized that independent board members are vital for the organization and shareholders interest. They should be enough in numbers to oversee management of the company (Mishra, 2018).

Muneer and Allam (2017) explained the concept of board of directors in the firm. According to their study, board of directors includes the CEO, non-CEO, affiliated outside directors and non-affiliated outside directors. CEO is the person who often serves as a chairman of the board, non-CEO is considered as officers of the company. Affiliated directors defined as the directors who are former employees of the company, relatives of the employees of the firm or who have any kind of business relationship with the company, and nonaffiliated outside directors are the individuals having no past or present relationship with the firm.

The board of directors is a collective body that should act in the best interest of their company shareholders. Board is a combination of executive and non-executive directors to pursue the shareholders' interest. The non-executive directors are not the full-time employees of the company as compared to executive directors who are full-time employees and are involved in day to day activities of the company. Role of non-executive directors is to pursue monitoring mechanism of performance and activities of management or executive directors. The non-executive directors on the board prime duty is to provide unbiased judgments, and that is only possible when independent board is vital to exercise their duties. The code of corporate governance and regulators suggests that mere compliance with recommendations is not enough, it is essential that composition of board members should be balanced and independent to perform effectively. In general, the representation and independence of non-executive directors is vital for the board's effectiveness (Fuzia, Halim, & M.K, 2016).

The phrase board characteristics comprises of two concepts in it. Former is the board (usually known as board of directors) is vested with the duty to hire managers and administrating the activities of these managers as well as overall organization. The latter typically means the quality of something or someone. From this concept board characteristics can be explained as internal corporate governance mechanism which expounds on the features of the board (Akeju & Babatunde., 2017). Characteristics

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