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BOARD COMPOSITION AND FINANCIAL PERFORMANCE

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ABSTRACT: ***The broad objective of the study was to review extant literature on board composition and financial performance in Nigeria. It became imperative to conduct this study following the series of quest to observe which form of board composition enhances financial performance in Nigeria. The study is a conceptual paper in which a holistic review of literature was done on the impact of board composition on financial performance in Nigeria which provided a theoretical frame of reference for the study. The study also compared past studies to show their weaknesses and strength. For the purpose of this review, related materials were gathered from the internet and research gate database. The paper combines empirical findings on the relationship between selected dimensions of board composition and firm performance. The paper identifies shortcoming of past studies and concluded by offering some avenues for future researches in this promising area of empirical research.***

INTRODUCTION

Acceptable reaction to the question of whether board composition influences corporate firm performance can be accomplished via the review of the outcomes and findings of prior empirical studies (Kajola, Onaolapo, & Adelowotan, 2017; Kakanda, Bello, & Abba, 2016). Contemporarily, substantial concern has been geared towards the influence of board composition on firm performance. This continuous interest on governance mechanisms has been upheld as a result of global corporate failures, financial scandals and global financial meltdown which resulted in universal loss of public reliance and confidence as well as investors' indifference (Ilaboya & Obaretin, 2015).

Corporate board of directors are seen as the greatest swaying mechanism of corporate governance saddled with the duty to direct the activities of corporate executives (Kajola et al., 2017). However, the board remains ineffectual in advancing firm performance which resulted several corporate failures such as Enron and WorldCom in the USA, Pamalat in Italy, HIH Insurance and Onetel in Australia, Savannah bank, intercontinental bank, oceanic banks as well as Cadbury in Nigeria (Kakanda et al., 2016). The corporate failures in Nigeria stemmed from an unproductive use of corporate governance, where a number of corporate boards of directors undermined their oversight functions on the executives' actions and similarly lack the requisite knowledge and abilities to implement good governance on management (Kakanda et al., 2016).

Members of board of directors in both public and private companies are entrusted with numerous duties. These duties include a moral duty to epitomise the interest of investors (potential and existing) and shareholders and to monitor the corporate financial steadiness and performance (Ethics Resources Centre [ERC], 2002). Dalton and Dalton (2011) documented that the sway of the board on firm performance has normally been evaluated using variables associated with their corporate structure and composition but such evaluations have usually been abortive in ascertaining any significant connection between these factors and firm financial performance. Also, Rebiz (2015) documented that empirical studies on the subject matter have been non-inclusive and disjointed as a result of the research idea of the diverse scholars. Succinctly, Rebeiz (2015) opined that ontological complexities prevented researchers' agreement on board composition and firm performance due to the complexity of the organisation's legal, economics and social systems which plays an inter-influence role between organisations and the external environment. The positivist's researchers employ market or accounting indices in determining firm performance, whereas both measures suffer from measurement setbacks. The accounting metrics are based on historical values from financial statements while market metrics are based on future expectations influence by the forces of demand and supply in the market. While, behavioural complexities was viewed on the basis that directors independence is influenced by the existing culture in the boardroom and information control by the Chief Executive Officer (CEO) which hinders independent judgment by board members (Rebeiz,2005).

Prior studies (Abu, Okpeh, & Okpe, 2016; Gambo, Ahmed, & Rimanshung, 2018; Ilaboya & Obaretin, 2015; Kajola, Onaolapo, & Adelowotan, 2017; Ombaba & kosgey, 2018) on the effect of board characteristics on the financial performance of firms have measured financial performance as either using accounting based performance measures like Return on Assets (ROA), Return on Equity (ROE), Net Profit Margin (NPM), Earning Per Share (EPS) and Dividend Per Share (DPS). Furthermore, market based measures like Tobin's Q (Kyereboah-Coleman, 2007; Yermack, 1996). Similarly, board of directors characteristics is measured using constructs like board size, board meeting, board independence, board gender diversity, audit committee independence and board expertise and education.

Hence, this study is intended at reviewing the findings of prior studies that investigated the association between corporate characteristics and firm financial performance, and to identify possible gaps in literature. The paper is divided into sections: section two the concept of financial performance; section three presents board composition; section four presents review of empirical studies; section five presents review of theories while section six presents conclusion and recommendation.

Financial Performance

Corporate performance is a vital prerequisite for corporate survival and growth (Kakanda et al., 2016). Financial performance has become a significant concept in accounting, business and strategic management research but there is hardly a harmony on the meanings and measurement of financial performance. Rahman and Haniffa (2006) logically documented that corporate financial performance can be used to ascertain its operating performance. Firm financial performance refers to the process by which inadequate resources available to the organisation are used effectively and efficiently in achieving the corporate objectives for both current and future opportunity (Yasser, Entebang, & Abu, 2011). According to Berger and Patti

(2002), firm financial performance is measured by how 'better off' the shareholders are at the end of the financial year than they were at the beginning.

Rationally, since agency theory states that agency relationships should be the most underlining fact when studying and evaluating corporate governance mechanisms (Kajola et al., 2017; Yasser et al., 2011). Thus, it is implicit that involvement of board of directors in corporate performance helps in decreasing agency costs resulting from conflict of interests between the executives and the traditional corporate goals and procedures (Mizruchi, 1983). Similarly, it is anticipated that active board of directors will improve and smoothen the financial performance of their organization by capitalizing on shareholders wealth.

Board Composition

In a self-motivated business environment, the board of directors has become very significant for the smooth running and routine activities of the organisations. The corporate boards of directors are burdened with the duty of monitoring of the managerial activities to lessen agency costs, providing oversight advice and direction to the Chief Executive Officer (s) (CEOs), hiring and firing management, providing strategic directions for the company (Kemp, 2006; Mcnulty, Robert, & Stiles, 2005). Consequently, from the agency theory viewpoint, the board of directors also seeks to protect the interests of shareholders in a progressively modest business environment while sustaining managerial competence and responsibility in the pursuit of good firm performance (Murphy & Mitchell, 2007; Yasser et al., 2011).

As a result of the agency relationships, managements have substantial autonomies and influences to manage shareholders capitals and it is assumed that the executives may have some interests that may be in conflict with the interests of the shareholders, thus undermining shareholders wealth maximization. Thus, the board of directors is accountable for performing diverse roles of observing and overseeing management conducts to reduce agency conflicts and support the interests of management and shareholders (Fama & Jensen, 1983; Yasser et al., 2011).

From the resource dependence theory perspective, the board of directors can be seen as a strategic resource of the organization. Given that all organization depends on others to survive and thrive, the resource dependency theory suggests that managing external associations, leverage, and resources is the main objective of the board. Hence, members are carefully chosen for their background, contacts and skills (Pfeffer & Salancik, 2003; Yasser et al., 2011).

Board composition in this review has been advanced based on the agency and resource dependence theory. Board composition, in relation to these theories, includes board size, board independence, board meeting, board gender diversity, audit committee independence, and board tenure. Board size connotes the total number of directors on a corporate board. Board size consideration has been a subject of significant research in terms of its relationship with firm performance. Board independence refers to a corporate board with majority of outside and non-executive directors. The Nigerian Code of Corporate Governance (NCCG, 2018) defines an outside or independent director as a Non-Executive Director (NED) who is not a significant shareholder, not a representative of a shareholder, not a specialised advisor to the company, not a supplier or customer of the company or the group, and not a member of the direct family of any individual who is, or has been in any of the past three financial years engaged by the company or the group in the executive capacity. Board meeting is measured in terms of the number of times and the regularity of the meeting held by the board to thoughtfully discharge its governance and monitoring duty. There are many costs linked with directing board meetings such as managerial time, travel expenses and directors' meeting fees (Kajola et al., 2017; Yasser et al., 2011). Also, there are benefits comprising more time for directors to consult, set policy and monitor management. Audit committee independence is measured by the percentage of independent outside and non-executive directors in the committee. Audit committee forms part of the internal control mechanism of the company and helps to support corporate governance. Board tenure is the number of years a board member is mandated to be on the board. Longer tenure of the member will result in greater skill and knowledge gained by the board (Johl, Johl, & Cooper, 2015; Pfeffer, 1987). Board gender diversity is the inclusion of female directors on the boards.

Review of Empirical Studies on Board Composition and Financial Performance

The impacts of board composition on financial performance have witnessed both national and international considerations in recent time. Hence, the plethora of literatures on the subject matter in Nigeria (Ilaboya & Obaretin, 2015; Kajola et al., 2017; Gambo, Ahmed, & Rimanshung, 2018); Ombaba and kosgey (2018) in Kenya; Johl et al. (2015) and Hutchinson and Zain (2009) in Malaysia; Bathula (2008) in New Zealand; Alshetwi (2017) in Saudi Arabia; Yermack (1996) in USA; Coleman and Biekpe (2007) in Tunisia; Ahern and Dittmar (2012) in Turkey. Flowing from this, the determinants of board composition and financial performance are discussed below:

Board Size and Financial Performance

Board size is the total number of directors on a board and this can determine how active the board is in discharging its monitoring and oversight functions. The pioneer study on the association between board size and firm performance suggested a board size of 7 and 8 and resolved that larger board size may result in time consuming effort in decision making (Lipton & Lorch, 1992). Ilaboya and Obaretin (2015) concentrated on a sample of 166 firms quoted in the Nigerian stock exchange from 2005 to 2012 in the food and beverage sector found a positive and statistically significant association between board size and firm performance. Their findings buttressed the findings of Bathula (2008) who investigated the effect of board size on firm performance using 158 quoted companies in New Zealand from 2004 to 2007.

Consequently, Kajola et al. (2017) examined the association between board size and firm performance of 35 non-financial firms listed in Nigeria stock exchange from 2003 to 2014 and found a positive and significant association between board size and firm performance. Also, Gambo, Ahmed and Rimanshung (2018) examining a sample of 20 listed consumer goods companies in Nigerian stock exchange from 2006 to 2015 and found no significant association between board size and firm performance. Their findings agree with the findings of Alshetwi (2017) and Ashraf, Mohamed, and Youssef (2018). Yermack (1996) investigated the relationship between board size and firm performance and concluded that the smaller the board size, the better the performance and recommended an ideal board size of ten or fewer. Larger board size may lead to slow decision making and high monitoring costs but can reduce and counter CEO weight and overbearing influence, bring about knowledge pool and the availability of resources provided by the board in line with the resource dependence theory.

Board Independence and Financial Performance

The board of directors involves the executive and non-executive directors who are either independent or non-independent. The board independence is measured by the ratio of independent non-executives directors on the board. Independent non-executive directors are external directors who do not directly or indirectly have financial stake in the company. The NCCG (2018) stipulates that an independent non-executive director should be independent in character and judgment and accordingly shall be free from such relationship or circumstances with the company, its management, or substantial shareholders which may, or appear to, impair his ability to make independent judgment. Johl, Kaur and Cooper (2015) examined board characteristics and firm performance in 700 listed companies in Malaysia from 2009 to 2014 using OLS to analyze the data and found the existence of independent directors on the board to have no significant effects on the performance of firms in Malaysia. Abu, Okpeh, and Okpe (2016) and Ilaboya and Obaretin (2015) found independent directors to have no significant effect on firm performance. Alshetwi (2017) reported that board independence is not associated with firm performance using a sample of 320 non-financial firms listed in Saudi Arabia stock exchange. However, some studies found board independence to be positively associated with the performance of firms (; Bhagat & Black, 2002). Haniffa and Hudaib (2006) indicated that an effective independent board helps reduce agency costs resulting from misallocation of resources. Though, studies on the relationships between board independence and firm performance produce mixed results. An independent board with a majority of non-executive directors can provide firms' with better experience, skills and contacts but that does not necessarily translate to better firm performance.

Audit Committee Independence and Financial Performance

Audit committee is an internal corporate governance mechanism that is responsible for the supervision of management activities and ensuring strict compliance with financial regulations. The effectiveness of this committee depends on its composition, expertise of its members and its independence. Audit committee independence is measured by the percentage of independent non-executive directors to the total numbers of audit committee members. NCCG (2018) clearly specifies the formation of six members audit committee for all public companies. The audit committee should comprise three non-executive board members and three shareholders elected from among them at each annual general meeting. The idea of splitting the audit committee membership into an equal number of representations is to ensure the independence of the committee. Ilaboya and Obaretin (2015) argued that audit committee independence enhances the oversight function of the committee which will no doubt translate into improved firm performance. They found audit committee independence to have significant effect on firm performance in the food and beverage firms listed in the Nigerian stock exchange. Krishnan (2005) posit that independent audit committee with the requisite expertise will help to reduce internal control issues in the organization. Naseem, Xiaoming, Riaz, and Rehman (2017) found audit committee independence to have positive effects on firm performance in the emerging economy of Pakistan using OLS. Conversely, Hutchinson and Zain (2009) studied 60 Malaysian companies and found no positive relationship between audit committee independence and corporate performance. Audit committee will impact on the performance of firms more only when the committee is entirely independent and comprises members with the requisite skills, knowledge and experience.

Board Gender Diversity and Financial Performance

In corporate governance, board gender diversity is the presence of female directors on the board. It is generally considered that female board members are more independent because they are not part of the “old boys” network (Carter & Simpson, 2003). Ahern and Dittmar (2012) investigated the association between board diversity and firm performance for the largest listed firms in Turkey and found that women directors add new perspective to the firm strategy which invariably improves the firm performance. The result imply that gender diversity may have larger role, if the firms have more female directors rather than women CEOs/GMs. Byrness et al. (1999) opined that the participation of women in the board governance can help avoid risky projects as they are generally financial risk-averse than men. Female directors obviously seem to impact on the effective performance of the board which will translate to firm performance. The question now, is how many female directors will be on the board for them to have a say. However, diversity should not only ensure equitable representation but also provide for an expression of broadening the principle of merit (Burton, 1991).

Board Tenure and Financial Performance

Board tenure is the average number of years the firm’s directors have served on the board. Longer tenure of the member will result in greater experience and knowledge gained by the board (Pfeffer, 1987). Board tenure is a unique observable characteristic of a director’s experience with a specific company. We assume that companies want to retain directors for some time because their ability to monitor and advice increases, at least initially, as they acquire more knowledge about the company. Furthermore, replacing directors too frequently is costly in the time and resources a new director needs to learn about the company. However, longer tenure may result in over familiarity and complacency which will translate to dilution of independence of the board. Ombaba and kosgey (2018) examined the impact of board tenure on financial performance in Kenya using a sample of 57 listed firms in Kenya stock exchange during the period of 2007 to 2016. They found board tenure to be negatively related to financial performance. A board acquires more firm-specific knowledge as board tenure increases, which is associated with an increase in firm value. However, increased familiarity between the board and management can undermine board independence there counteracting the benefits associated with it.

Review of Theories

Agency Theory

The agency theory is a model used to examine the relationship between the principal and the agents in which the principal engages the agents to apply essential measures to maximize the wealth of shareholders (Uwuigbe, 2011). Musa (2012) asserts that the agency relationship occurs where the owners of a company entrust the routine operations of the company to another party (the agents) to help manage in line with the expectations of the owners. This claim was further expatiated that such association is contractual and the agents must make decisions, carry out functions that supports owners’ expectations. The theory is exclusively anchored on the cautious need of the agents to protect and to always uphold the interests of the shareholders.

Patton and Baker (1987) documented that the decisions made by the agents are occasionally opposing to shareholders' interests. In achieving the objectives of this research, agency theory would be adopted in examining the impact of board composition on firm performance. Furthermore, the theory helps explain the contractual relationship between the agents and the principals.

CONCLUSION

The broad objective of the study was to theoretically review extant literature on board composition and financial performance and to identify possible literature gaps. The review is based on causal-effect relationship between board attributes such as board size, board independence, audit committee independence, board tenure, board gender diversity, and financial performance. Although, there are ample of studies on board composition and firm performance, thus far there are still conflicting results which make research in the area to be inconclusive. Nevertheless, this does not render the findings of prior studies invalid. More significantly, prior studies have shown restrictions that outlined the problem that is associated with the connection between board composition and firm financial performance might be swayed indirectly by other elements like social, economic and political that might be the strengths, weaknesses, opportunities and threats (SWOT) posed by the market within which the business operates. The association can also be swayed by the diverse roles played by boards to arrive at strategic outcomes which later sway performance (Zahra & Pearce II, 1989). This is an avenue for future researchers to use mediations or moderations in investigating association between board composition and firm performance.

Methodological complications and the use of historic data is another drawback in studies of board composition and firm performance (Rebeiz, 2015). This drawback can be decreased by incorporating empirical investigation with explanatory reasoning. This will help future researchers to have more result that is dependable since analyses from both secondary and primary data source will be complementing each other in result interpretations.

The use of archival data from diverse sectors on a stock exchange can also influence the result of a study. Diverse sectors are branded by diverse industry standard, diverse accounting policies, size and periods of operation. Future researchers can use companies with similar features or make relative analysis between firms from available sectors. In addition, contradictory results from studies in diverse countries might be due to economic and political dissimilarities among nations.

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