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BOARD STRUCTURE AND FIRM PERFORMANCE: A REVIEW OF LITERATURE AND EMPIRICAL CHALLENGES

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Abstract

Corporate governance over the years has become an issue of global concern due to the 2008 economic crisis and several financial scandals and corporate failures. This has drawn the attention of researchers, investors and regulatory institutions. Moreover, the most significant mechanism of corporate governance is board of directors. Therefore, the purpose of this paper is to review previous studies that examine the relationship between board structure antecedents and firm performance, and to identify possible literature gaps. While the need to assess the connection between board structure and firm performance would for a longtime remained a legitimate and interesting area of investigation, the paper recommend that the researchers avoid mistakes of the past. These include over reliance on singular *theory, the use of lone performance measure and most importantly the assumption of express relationship between the two variables. The use of more purposeful process-based approach that identifies the cause effect of the relationship would be of tremendous benefit to this vital field of study.*

Keywords: Corporate Governance, Board Structure, Firm Performance, Corporate failure

INTRODUCTION

The relationship between board structure and firm performance has been a widely debated and well-researched topic in the developed countries context. However, in the past few years, this issue has also been discussed in the context of emerging countries, such as Iraq, in light of the recent corporate collapses and scams (Arora & Sharma, 2016). The corporate collapses resulting from a weak system of corporate governance highlighted the need to improve and reform the governance structure. Firms' governance plays an important role in the probability of accounting frauds and firms which have a weak governance structure being more prone to accounting frauds (Berkman et al., 2009). The failure in preventing these scams has fueled many debates on the effectiveness of current corporate governance rules, principles, structures and mechanisms (Sun et al., 2011).

However, companies with weaker governance structures have to face more agency problems and managers of such firms gain more private benefits (Core et al., 1999). Agency theory suggests that the directors of a firm are not likely to be as careful with other people's money as with their own fund (Letza et al., 2004). The theory further states that the main purpose of corporate governance mechanisms is to provide assurance to the shareholders that managers are working toward achieving outcomes in the shareholders' interests (Shleifer & Vishny, 1997). Finkelstein and Mooney (2003) argue that board of directors play a various and significant role in effective operations of corporations that include advice, oversight, counsel, and monitoring of the Chief Executive Officers (CEOs), and if necessary, to offer disciplinary actions on them.

In the past two decades, there has been an increased intensity of research on the relationship between board structure antecedents and firm performance. But the issue has mainly been explored in developed countries (Gottesman & Morey 2006; Goldman et al., 2009; Marinova, et al., 2016; Miller & Triana, 2009; Niessen and Ruenzi, 2010; Williams & O'Reilly, 1998; Volonte´& Gantenbein, 2016). The empirical work on this issue is still at its infancy in the context of developing countries like Iraq, perhaps due to the relatively opaque disclosure practices followed by companies or the data unavailability problem. Moreover, most of the previous studies on Iraq focused on financial performance (Jedi & Nayan, 2017; Jadah & Adzis 2016; Talab, et. al, 2017) neglecting the non-financial aspects of performance and they used secondary data in their studies.

The remainder of this paper is organized as follows: Section 2 reviews the literature on the relationship between board structure antecedents and firm performance; Section 3 discusses the theoretical background of the study Section 4 presents the board roles, structure and firm performance and finally, section five provides the conclusion.

REVIEW OF LITERATURE

Corporate governance issues continue to dominate accounting literate due to its significant contribution to economic growth and development (Talab, et al., 2017). Several attempts were made in developing countries to conceptualize the issue of corporate governance from the perspective of agency theory, however it has been faced with challenges. Some studies like Bhuiyan and Biswas (2007); Solomon et al., (2003) focused are on the impact on board structure on firm performance; Campbell, Jerzemowska and Najman (2009) conducted compliance studies; Tsamenyi, Enninful-Adu and Onumah (2007) while studies like Siddiqui (2010) concentrated on the state of corporate governance implementation in emerging market. Findings from many of the corporate governance studies from emerging market revealed that corporate governance practice is weak.

Companies' boards are charged with the responsibility of overseeing the activities of corporate managers on shareholders' behalf (Uadiale, 2010). Consequently, for the board of directors to perform their functions effectively, some attributes like board size, board composition, board meetings, board expertise and so on must be in place (Kakanda et al., 2016a; Vafeas, 1999). In the light of the above, the effectiveness of the board of directors' oversight function is influenced by some factors like board size, board composition, CEO duality, board culture, information asymmetries, and board diversity. However, much of the standard related literature examines the interrelation between firm performance and some subset of several measurements of corporate governance, such as insider–outsider ownership, board composition, board size, executive compensation and board tasks (Jensen, 1993; Yermack, 1996; Dalton et al., 1999; Coles and Hesterly, 2000; Elsayed, 2007; Bhagat and Bolton, 2013). In this section, we review the related literature, and as research on this issue is quite voluminous, we mainly cover issues related to board structure antecedents and their linkage with firm performance.

One of the issues that have become the interest of researchers pertaining to the board of directors is the impact of BOD's education on the firms (Adnan, et al., 2016). However, a number of studies have been conducted globally in this area. Some researchers tried to explore the impact of BOD's education with the company performance such as Bathula (2008) who found that education diversity in the form of PhD and non-PhD holders affects company performance. Another study in an emerging economy by Mahadeo et al. (2012) on the other hand showed negative relationship between the education diversity and the performance of companies listed on Mauritius Stock Exchange. Educational background measures the cognitive ability of the executive, which influences firm performance:

Hambrick and Mason (1984) suggested that executives' educational background provides an indication of their knowledge and skill base. The type and number of degrees of education one chooses serve as indicators of her or his values and cognitive preferences. Thus, based on personal values, cognitive preferences and specialized education, we might expect those with formal education in engineering to utilize different cognitive models in making decisions than those with formal education in business or finance (Hambrick and Mason, 1984). Hitt and Barr (1989) found that managers with higher levels of formal education made different managerial compensation decisions from those with less formal education. Hambrick and Mason (1984) proposed that firms having top managers with less formal education experience more variability in performance.

A significant trend seen in the area of board structure is the ethnic diversity among directors of a company. Boards of directors are leaders in the firms and responsible for taking a strategic decision and setting strategic goals. Diverse boards may monitor managers and top management teams in a better way. Because board diversity increases board independence (Carter, Simkins et al., 2003). Ethnic diversity among the board of directors can perform their responsibilities more effectively (Marimuthu and Kolandaisamy, 2009). However, there is ambiguity among previous research regarding diversity issue at board level (Hassan, et al., 2015). For instance, Gul, Munir & Zhang (2016) examines whether there is an association between board ethnic diversity in Malaysian firms and firm performance. The finding of the study revealed that the association between ethnic diversity of boards and firm performance is non-linear; at low levels of ethnic diversity there is a positive association but at higher levels of ethnic diversity, the association is negative. Further, when they split our politically connected sample into Malay and non-Malay dominant boards, they found generally, that in both groups of firms, board ethnic diversity does not influence firm performance.

In contrast, board diversity is considered as an advantage where different types of directors provide different beneficial resources to the firm (Hillman et al., 2000). Similarly, ethnically diverse boards are expected to offer firms more extensive networks and more comprehensive, non-redundant resources. It is also argued that individuals from different ethnic groups have different sets of attitudes, cognitive functions and beliefs (Robinson and Dechant, 1997), and that these attributes encourage the viewing of issues from different perspectives, as well as promote healthy debate and dissent where appropriate (Williams and O'Reilly, 1998). As a result, ethnically diverse boards are likely to produce high-quality decisions and possess effective problem-solving skills. Similarly, Agency theory, on the other hand, suggests that ethnically diverse boards are expected to provide better monitoring because boards consisting of directors from different ethnic groups and cultural backgrounds might ask more critical questions that would not come from directors with similar attributes (Carter et al., 2003). Kim et al. (2013) demonstrated that a diversity of viewpoints within the board is associated with better firm performance because the diverse viewpoints encourage more objective monitoring. This consequently results in lower agency costs and less discretionary power for insiders over the use of a firm's resources.

Furthermore, there is also an ongoing debate on the issue of board political connection and firm performance, but the empirical studies on this issue reveal a conflicting set of results. Some of these studies have shown that politically connected corporations perform better than firms without political links (Dicko, 2016; Dicko & El-Ibrami, 2013).These studies, conducted mainly in the United States and Canada, have shown that companies with connections have better market (Goldman et al., 2009) and accounting performances (Dicko, Khemakhem & Zogning, 2019) than companies that are not connected. Faccio (2006) found that the value of a firm increases when there is a strong political connection. Similarly, after analyzing the price reaction of equities during the 2000 presidential election, Goldman et al. (2009) found that the American firms connected to the political party increase their value. Ang et al. (2013) show that political connections have a positive effect on the value of the firm by considering the case of Singapore. However, Ding et al. (2014) confirm this same positive effect by taking the case of China. On the other hand, Faccio and Parsley (2009) prove that the firms affected by political connections are decreasing their value after announcing the unexpected death of a politician. Moreover, firms with stronger connections are financed with more long-term bank loans and are more likely to overinvest, which partially explains the puzzle of adverse effect of political connections on performance. Taken together, they concluded that cultivating political connections could be a risky investment and may not always pay off.

Gender diversity on a board has been an issue that is attracting tremendous attention from various parties including governments, corporations, academicians, and the public (Kılıç & Kuzey 2016). Several theoretical arguments exist regarding the relationship between female representation on boards of directors and the performance of their firms. However, based on the mixed and sometimes contradictory results in prior literature, there is still no consensus regarding the association between having females in the boardroom and firm performance (Kılıç & Kuzey 2016). In fact, these mixed results are not unexpected, since the link between board diversity and firm financial performance is both theoretically and empirically complicated (Carter et al., 2008).

Several arguments in previous literature support the positive effect of female directors on firm performance. First, board diversity implies that diverse directors can increase the profitability and value of their companies by adding unique characteristics, abilities, and talents to the boardrooms (Carter et al., 2008). Second, gender diversity can enhance problem-solving abilities by inserting different perspectives into board discussions (Burke, 2003; Rose, Munch-Madsen & Funch, 2013; Campbell and Mínguez Vera, 2008). In this regard, different perspectives can offer alternatives to decision makers and enable more careful considerations of such alternatives (Carter et al., 2003). Hence, a board of directors with different skills, cultural backgrounds, and gender provides a strategic resource, thus enhancing firm performance (Ujunwa et al., 2012).

CORPORATE GOVERNANCE THEORIES AND UNDERLYING PRINCIPLES

As corporate governance issues took centre stage in the management and operation of modern enterprise so is the schism of theoretical models (Kirkbride et al, 2004). However, the lack of consensus in the definition of corporate governance resulted in researchers from different background (Finance, Economics, Sociology, and Psychology) coming up with their respective theoretical views, all aimed towards aiding understanding of the complex nature of the concept. The most widely studied of these theories includes.

Agency Theory Perspective

Agency theorist has a collective view that BODs primary assignment is monitoring management, and that only directors who are independent can monitor vigorously (Bhagat & Black, 2000). They further argued that organizations are often recognized with a clash of interest between management and shareholders, where managers (agents), frequently portrays an opportunistic behavior by exploiting their control over firm operations to increase their short-run benefits at the expense of shareholders'(principals) long-run wealth. However, existence of vigilant BODs could reduce such agency problems through tight monitoring of their company's management (de Villiers et. al 2011, Zahra & Pierce, 1989).

Resource Dependence Theory Perspective

The resource dependence approach developed by Pfeffer (1972) and Pfeffer and Salancik (1978) highlights the role of outside directors (non-executive directors). Non-executive directors enhance the ability of a company to have more choices on resources, protect itself against the external environment, and reduce market uncertainty. Therefore, non-executive directors are able to raise the business's opportunities to generate funds or enhance the business's reputation and status.

According to Johnson, Daily, and Ellstrand (1996) BODs are selected based on their resources "(reputation, knowledge, and networking)" as it is expected that the company will benefit from such resources. Likewise, they might bring in their experience and knowledge from other firms into the firm they are now serving as the director. From the resource dependence perspective, board influence on company performance occurs through its impact on the Strategic initiatives of CEO choices, directors can shape these initiatives directly by proposing new business concepts or initiating their analyses (Zahra & Pearce, 1989, p.299). Also, suggests that directors may be actively involved in the strategic arena through counsel and advice to the CEO, by initiating their own analyses, or by suggesting alternatives. However, directors may not develop or execute strategies because these activities are within the purview of the CEO" (Zahra & Pearce, 1989, p.298).

Legalistic Perspective

From this perspective, the legal duty of BODs is to safeguard the interest of the shareholders through monitoring and guiding management decisions without interfering in the firm's daily operations which remains the responsibilities of both senior executives and their chief executive officer (CEO) (Zahra & Pierce, 1989). The BODs have prescribed legal responsibilities to be delivered through its control and service roles. However, the control roles include appointing and replacing CEO and reviewing management strategies and decisions, whereas service roles encompass advising management, linking a professional network with industrialists, and raising the corporate reputation (Carpenter, 1988; Mueller, 1979). Effective performance of these boards' roles enhances firm performance.

Based on this perspective, a board is not anticipated to initiate strategies or develop policies. Instead, it is responsible for reviewing and approving managerial initiatives that will, in tum, determine company performance. It also requires evaluating company and CEO performance to ensure corporate growth and protection of shareholders' interest (Zahra& Pierce, 1989, p.294).

Class Hegemony Theory Perspective

This theoretical perspective on the role of BOD is emanated from the Marxist sociology (Nichols, 1969; Zahra & Pearce, 1989) which reveals that directors stands to be an elite group that perpetuates the powers and the interest of the ruling capitalist in a company within a country. Under this theory, only the most influential and reputable personalities are appointed to serve in a board to coordinate, protect and ensure the interest of the capitalists control of societal institutions. In this theory, firm's strategies are initiated and implemented by the CEO while the directors will review the strategies and its implementation since the "CEOs are representing the values of the capitalist elite" (Zahra & Pearce, 1989, p.300). The BODs are considered as a device to ensure that the decision of CEO is always aligned with that of the owners.

Managerial Hegemony Theoretical Perspective

This theoretical perspective ascribes more powers to the management than the board who should oversee them. Management are power brokers here because they possess adequate information, experience of company operations, and thus make their decisions without any hesitation, rendering the board to become less relevant, with a lesser role in the boardroom (Zahra & Pearce, 1989).

Stakeholder's Theoretical Perspective

This theory focuses on a divergent group of individuals who are mandated beneficiaries of the information, profit (loss) of a company's performance. In this theory, shareholders' rights are dilute with the right of other stakeholders which comprises; employees, creditors, suppliers, customers, regulators (government), society and the general public. Therefore, the primary duty of the board is to protect the interest of all these group members without focusing on only shareholders' interests, as obtains in agency theory (Zahra & Pearce, 1989).

Stewardship Theory Perspectives

This perspective is grounded in the stewardship theory that was brought by Donaldson and Davis (1991) which profound the relationship of managers as stewards of the corporate owners. They have to ensure a sound system of reporting is maintained through the BOD that oversees them. Managers are motivated by achievement, and they do their best for the firm, owners they serve (Donaldson & Davis, 1991). This theory is of the belief that inside (executive directors) on the board, contributes to higher shareholders' returns due to their vast knowledge and experience about the firm's operation (Donaldson, 1990).

Table 1: Summary of Theoretical Perspectives of Boards' Roles

No	Theoretical Perspectives	Board Functions	Roles	Theoretical Origin	Representative studies
1	Agency Theory	The primary function of the boards is to monitor the actions of the agents (management) to ensure their efficiency and to protect the interests of principals (shareholders).	Control Strategies Service	Economics & Finance	Jensen & Meckling (1976) Fama & Jensen (1983)
2	Resource Dependence theory	1. Boards are a cooperative mechanism to extract resources vital to company performance. 2. Serve a boundary spanning role. 3. Enhance organizational legitimacy	Service Strategies Control	Organizational theory & Sociology	Pfeffer (1972) Pfeffer (1973) Pfeffer & Salancik (1978)
3	Legalistic	1. Representing and protecting shareholders' interest. 2. Managing the corporation without interfering in day to day operations.	Control Service	Corporate Law	Mace (1971) Molz (1988) Chaganti et al. (1985)
4	Class hegemony	Boards perpetuate the power and control of the ruling capitalist elite over social and economic institutions.	Service	Marxist Sociology	Nichols (1969) Carpenter, (1988)
5	Managerial Hegemony	Boards are "a legal fiction"	Service	Organizational theory	Mueller (1979)
6	Stakeholders	Boards pursue stakeholders' interest	Service	Politics, law & Management theory	Zahra & Pierce (1989)
7	Stewardship	Boards ensure the stewardship of corporate assets	Control	Organizational theory	Donaldson & Davis (1991) Donaldson (1990)

Source: Zahra & Pierce (1989), Stiles (1997)

BOARD ROLES, STRUCTURE AND FIRM PERFORMANCE

The corporate board is an internal governance mechanism designed to control self-interested management from unscrupulous behaviors (Heracleous, 2001; Guan et al., 2007). In the face of separation of ownership and control, board is the only intermediate arm of the firm that interfaces and administers the relationship between the shareholders and the managers (Stiles and Taylor, 2001; John and Senbet, 1998). Recent inexorable corporate scandals around the world and the reforms that follows thereafter all focus on board as the antidote that would help address issues surrounding management un-bearing attitudes and promote best practices (Van den Berghe and Levrau, 2004).

However, the fundamental task of board according to literature is to ensure that management in absence of owners discharges their obligation faithfully in the best interest of shareholders. As final corporate authority body when comes to decision-making, the role of board is therefore diverse taking into account the fact that it also bridges gaps that exists between these two extreme continuums. However, the effectiveness of the board of directors as shareholders' monitoring mechanism can only be efficient if bounded with appropriate size, composition and leadership configuration. To this end, most code for best practices and corporate governance guidelines tend to focus critically on these board structure as the cornerstone to achieving the much-needed board effectiveness.

Board Structure

There have being a strong presumption that the effective use of board as internal governance mechanism is crucial to improved firm performance and profitability (Bhagat and Black, 1999; Weisbach, 1988, Brickley et al., 1994; Johnson et al., 1996; Rosenstein and Wyatt, 1990; Zahra and Pearce, 1989). While talk they said is cheap, more than two decades of empirical investigation, is yet to justify the above assumption as ambiguous findings continue to dominate empirical studies on the relationship between corporate governance and firm performance. Some of the board structure reviewed here includes board educational level, political connection, board ethnic diversity and female membership on board.

Board Educational Level

It is widely argued that executives' educational background provides an indication of their knowledge and skill base. In line with upper-echelon theory, the different cognitive orientation, values and knowledge based of top management such as corporate board significantly influence decision making and managerial behavior and thus influence firm performance (Hambrick and Mason, 1984).Education level is often viewed as a good proxy for human capital, knowledge base and intellectual competence (Wiersema and Bantel, 1992). As stated by Carson et al. (2004), upper-echelon theory supports that higher educational background of top managers or BODs and their organsational decision-makers have substantial effects on firm performance.

Board Ethnic Diversity

The current literature reveals the fact that the relationship between diversity and organizational performance can be either positively correlated or negatively correlated or even some studies show that there is no relationship (somewhat mixed findings) between diversity and performance. Some empirical findings indicate that diversity results in greater knowledge, creativity and innovation and thus, organizations tend to become more competitive (Watson et al., 1993). In addition, improvement in decision making at strategic level can also be seen in the presence of diversity (Bantel, 1993). Siciliano (1996) found that board diversity paves a way for positive results in performance. Cultural heterogeneity results in issue-based conflict which in turn enhances greater organizational performance. Heterogeneity is positively linked to better problem solving and offering creating solutions (Michael & Hambrick, 1992). Hence, diversity is positively related to performance. On the other hand, diversity can be disadvantageous to organizational performance (Hambrick et al., 1996), in which, homogeneous top management tends to produce better results as compared to heterogeneous top management. Similarly, Knight et al. (1999) also argues that team performance tends to deteriorate as diversity level increases.

Board Political Connection

The interaction between politics and business has been explained by the benefits generated for both politicians and businesses. According to Brogaard et al. (2015), the existence of a political power in the company helps its officers and directors have an impact on laws and regulations and gives them access to inside information, which enables them to anticipate economic changes and reduce uncertainty. Prior researchers have examined the effect of political connections on the company's performance and value (Li et al., 2015; Gilabert, 2011). However, the results of the previous research studies are generally mixed (Maaloul et al., 2018). For instance, Zhong (2016) analyzes the political connection and the performance of Merger and Acquisition (M &A) in China's A-share listed companies from 2007 to 2011. The findings show that the political connection degree of general manager or chairman has no significant impact on the performance after M & A, while has a significant positive impact on the performance of M & A in private enterprises. However, a considerable part of scholars believe that political connection will provide convenience for corporate development in all aspects to facilitate their better performance. Similarly, Maaloul, et al., (2018) showed that political connections improve companies' performance and value.

On the other hand, in Pakistan, Saeed, Belghitar & Clark (2015) investigated how politicians serving on the boards of directors' influence firm performance. The results show a negative relationship between political connections and firm performance. More so, Ling, et al., (2016) using a sample of 103 listed real estate firms from 1998 to 2012, examines the influence of firms' political connections on external financing, corporate investment, and financial performance. The results of the study indicate that political connections are negatively related to return on assets.

Board Gender Diversity

Gender diversity on a board has been an issue that is attracting tremendous attention from various parties including governments, corporations, academicians, and the public (Kılıç & Kuzey 2016). Several theoretical arguments exist regarding the relationship between female representation on boards of directors and the performance of their firms. However, based on the mixed and sometimes contradictory results in prior literature, there is still no consensus regarding the association between having females in the boardroom and firm performance (Kılıç & Kuzey 2016). Ongore et al. (2015), Shungu et al. (2014), and Pathan & Faff, (2013) found a positive relationship amongst the proportion of women directors and banks' performance. Conversely, Kilic (2015) found an adverse association between gender diversity and bank performance

CONCLUSION

The aim of this study is to review previous studies on board structure antecedents and firm performance and to identify possible literature gaps. The review is based on causal effect relationship between board structure dimensions such as board educational level, board ethnic diversity, board political connection, board gender diversity and firm financial performance. Albeit, there are stream of studies on board structure and firm performance, yet the results are still conflicting which make research in the area to be inconclusive. Nevertheless, this does not render the findings of previous studies invalid. The board roles as documented in literature are diverse ranging from monitoring, strategy, resource co-optation, and advisory amongst others (Jensen and Meckling, 1976; Daily et al., 2003; Hillman and Dalziel, 2003; Zahra and Pearce, 1989; Johnson et al., 1996). These numerous functionalities expected of board has makes it virtually impossible for a single theory to accommodate (Kiel and Nicholson, 2007). There is a need for permutation of new theories and models as well as more innovative empirical studies to really understand the importance of corporate board (Eisenhardt, 1989a; Jackling and Johl, 2009; Donaldson and Muth, 1998). The use of more integrative approach in the empirical investigation may induce the robustness and validity of the findings (Guerra et al., 2009). Most of the available theories might be out of touch with current corporate realities since they were built on certain premises and parameters that might have been either outdated or overtaken by recent events (Hermalin and Weisbach, 2003).

Moreover, future studies should consider reviewing other board structure components to examine their causal effects on the performance of companies. In addition, it is argued that corporate governance researchers have relied on singular theory for so long and this had not helped the field in gaining the much-needed appreciation of the relationship between board structure and firm performance. Future studies should integrate more theories in explaining the relationship between board structure and firm performance. Furthermore, future studies should also conduct an empirical study to examine the relationship between board structure and firm performance.

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