BOARD CHARACTERISTICS AND FIRM PERFORMANCE: EVIDENCE FROM INDIAN COMPANIES
Based on outcome of ICSSR sponsored Minor Research Project

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Abstract: This paper aims to study the relationship between the board characteristics and financial performance of the selected listed Indian companies. Board composition is an important element of corporate governance. Present study used a sample size of hundred Indian listed companies based on market capitalization. Board characteristics considered for the study are size of the board, proportion of outside directors, concentrated leadership structure (CEO Duality), frequency of board meetings and multiple directorship. Whereas, the financial performance ratios considered under this study are return on net worth (RONW), return on capital employed (ROCE), return on total assets (ROA) and Tobin's q. The outcome of the study shows that the firm performance has positive association with board size and multiple directorship, considerably low association with frequency of board meetings and proportion of outside directors and have negative association with concentrated leadership structure. The present paper is the outcome of a minor research project sponsored by Indian Council of Social Science and Research (ICSSR).

Index Terms – *Board characteristics, board composition, firm performance, corporate governance, Indian companies,*

I. INTRODUCTION:

Corporate governance refers to the internal governance mechanism of any organization. At global level, the need of strong governance is evidenced by the various reforms and standards developed e.g. the Sarbanes-Oxley Act in the US, CLERP 9 in Australia, Combined Code in the UK, and the Organization for Economic Development (OECD) Code etc. Further, board of directors possesses the pivotal role in the mechanism of corporate governance. Almost all the rules set for corporate governance across the globe, focuses on composition of the board as an essential integral part of it. In India, listing agreement clause 49, the Companies Act 1956, and the revised Companies Act 2013 have also focused on the board composition norms. Board composition provides uniqueness to the board and which enhances the various characteristics of the board. Various researchers have studies in the field of board characteristics and have found that it has crucial impact on the performance of the board (Yermack, 1996) (Dahya, 2007) (Wintoki, 2012). Researches on board characteristics and its impact on the performance of the organization have focused on the developed economies more, with compare to other emerging economies like India. (Daily C. &. 2003) (Rajagopalan, N. & Zhang, Y., 2008). This research aims to analyse the relationship between the board characteristics and financial performance of the selected listed Indian companies. Board composition is an important element of corporate governance.

II. REVIEW OF LITERATURE:

Various researchers have carried out research in the area of corporate governance at global level. Various evidence are available with reference to board characteristics like a board of directors with high levels of links to the external environment would improve a company's access to various resources thus improving corporate governance and firm performance. The resources that have been investigated as having added value to the firm include finance and capital (Burt, 1983) (Mizruchi, 1994) links to key suppliers (Banerji, 1996), customers (Frooman, 1999) and significant stakeholders (Freeman, 1990). The relationship between the board of directors and firm performance is more 'varied and complex' than can be covered by any single governance theory (Nicholson, 2007). In the context of corporate governance, agency theory implies that adequate monitoring mechanisms need to be established to protect shareholders from management's self-interest. Therefore, a high proportion of outside directors on the board in viewed as potentially having a positive impact on performance (Fama, 1983) (Jensen, 1976). Adams, Almeida, and Ferreira (Adams, 2005) argue that the ability of a CEO to influence decisions can have an impact on firm performance. This ability is considered to be contingent on the level of power of the CEO (Finkelstein, 1992). This notion stems from the idea that other executives on the board could be rivals for the CEO's power and position and will influence decision making together with the CEO therefore making the CEO less powerful. Using agency theory, it would be anticipated that the separation of the chairman and CEO roles leads to greater scrutiny of managerial behaviour and thus leads to better performance (Millstein, 1992). It is assumed that there are inevitable conflicts between parties that delegate (principals) and those who execute (i.e., agents) (Jensen, 1976).

One aspect of resource dependency theory linked with corporate governance and performance is the intensity of board activity, as measured by the frequency of board meetings. Lipton and Lorsch (Lipton, 1989) suggest that the greater frequency of meetings is likely to result in superior performance. An opposing view professed by Jensen (Jensen, 1976) is that routine tasks absorb much of a board's meeting time and thus limit the opportunities for outside directors to exercise meaningful control over management. The number of positions that directors accept on company boards has become known as the "busyness hypothesis" (Ferris, 2003). Some studies have reported that directors with multiple appointments have a positive impact on firm performance (Brown, 1999)(Ferris, 2003) (Harris, 2004) (Miwa., 2000). Board busyness has therefore been linked with the resource dependency theory, as there appears to be a theoretical argument that a board with a high level of engagement with the external environment provides access to various resources that improve performance. An alternate view is that a large number of appointments can make directors over-committed and consequently compromise their ability to monitor company management effectively on behalf of shareholders and adversely affect firm value (Erkens, 2012).

The busyness of Indian directors is partly explained by the fact that multiple directorships have evolved largely due to the lack of industrial leadership and adequacy of experience. Sarkar and Sarkar (Sarkar, 2008) using data from 2003 show that 71.6 per cent of Indian directors held more than one directorial position and 56 per cent of directors would be defined as "busy" based on the three-directorship benchmark. Multiple directorships in India have also been influenced by supply constraints in the managerial labour market (Brown, 1999). Additionally, given that family owned business groups typically dominate corporations in emerging economies multiple directorships are likely to be based on kinship and social and family ties for both inside and outside directors (John, 1998) (Haan, 2016). Chakrabarti et al. (Chakrabarti, 2008) report that in a study of 500 Indian companies higher firm value was associated with outside directors having multiple directorships. Overall, given the Indian context of limited expertise in the managerial labour market, it is proposed that multiple directorships have the potential to improve firm performance consistent with the resource dependency theory (Dahya, 2007).

III. OBJECTIVES OF THE STUDY:

Major objectives of the study are briefly explained as under:

- To study the board composition practices of selected listed Indian companies
- To determine the board characteristics of the selected companies
- To identify the association between board characteristics and firm performance parameters

IV: HYPOTHESES:

Following are the hypotheses of the present study:

H1: There is a positive association between the board size and firm performance.

H2: There is a positive association between the proportion of outside directors in the board and firm performance.

H3: There is a negative association between concentrated leadership structure and firm performance.

H4: There is a positive association between board activity (frequency of meetings) and firm performance.

H5: there is a positive association between multiple directorships and firm performance.

V: METHODOLOGY:

This study is exploratory research based on the secondary data. The sampling method adopted in the present study is purposive sampling. The researcher has selected top hundred listed Indian companies based on market capitalisation, excluding the banking and financial service provider companies, due to their separate norms and complexities in calculating the performance ratios like Tobin's q. The data is collected for the period of five financial years from 2011-12 to 2015-16, from the Prowess IQ database, published audited financial statements available on website of the companies and other reliable online sources. The researcher has developed the multiple regression model based on the financial performance ratios as dependent variable and board characteristics as independent variables. The rests applied are correlation analysis, multiple regression analysis and ANOVA. Table one presents the various sectors and number of companies affiliated with each sector. Table two presents the financial ratios considered for the study and table three presents the board characteristics considered for the study.

Table 1: Various Sectors and Number of Companies Affiliated with Each Sector

Sector	No. of Companies	Sector	No. of Companies
Drugs, Medical and Health	8	Crude Oil, Minerals, Metals and Refinery	19

Automobile and Ancillaries	13	Misc. Services	4
IT and Telecommunication	12	Construction and Infrastructure	2
Electricity, Transmission and Equipment	11	Cement	4
Machinery and Engineering	4	Paints, Varnishes and Chemicals	5
FMCG and Other Consumer Goods	15	Other Diversified	3

Table 2: Financial Ratios and Parameters considered for the study

Sr. No	Financial Parameters and Ratios	Calculation
1	Profit after Tax (PAT)	Profit after tax and other items from the profit and loss account of the organization
2	Non-current Liabilities (NCL)	Total non-current liabilities of the organization from balance sheet
3	Current Liabilities and Provisions (CLP)	Total current liabilities and provisions of the organization from balance sheet
4	Total Assets (TA)	Total assets of the organization from balance sheet
5	Average Total Assets (ATA)	Opening balance of total assets + closing balance of total assets / 2
6	Total Paid up Equity Share Capital (TPEC)	Total paid up equity share capital of the organization from the balance sheet
7	Market Capitalization (MCap)	Market value of share * total number of outstanding shares
8	Enterprise Value (EV)	Market value of common stock + market value of preferred equity + market value of debt + minority interest – cash and investments
9	Return on net worth (RONW)	Net income/ shareholders' equity * 100
10	Return on Capital Employed (ROCE)	Earnings before interest and tax (EBIT) / capital employed
11	Return on Total Assets (ROTA)	Earnings before interest and tax (EBIT) / total assets
12	Tobin's Q	Total market value of company + liabilities / total assets (or book) value + liabilities

Table 3: Non - Financial Parameters (Board Characteristics) used for the Analysis

Sr. No	Non-Financial Parameters (Board Characteristics)	Detail
1	Number of Board Meetings	Total number of board meetings attended by the board of directors during the financial year.
2	CEO – Chairman Duality	CEO of the company also possess the chairmanship of the organization.
3	Number of Directorship in other Companies	Total number of directorship positions held in other companies by board of directors during a financial year
4	Board Size	Total number of board of directors in a financial year.
5	Proportion of Independent Directors	Total percentage of independent directors in the board during a financial year

VI: RESULT OF HYPOTHESES TESTING:

Hypotheses testing result are varies for each hypotheses. The first hypothesis presents the association between the board size and firm performance. Testing shows that the null hypothesis is failed to reject, that means there is a positive association between the board size and firm performance for the selected organization under this study. Second hypothesis presents the association between the proportion of outside directors in the board and firm performance. Outcome of the result of hypothesis testing failed to reject the null hypothesis. It means there is a positive association between the proportion of outside directors in the board and firm performance. Third hypothesis presents the association between the concentrated leadership structure and performance of the firm. Outcome of the result of hypothesis testing failed to reject the null hypothesis. Thus, it is revealed that there is an inverse association between concentrated leadership structure and firm performance. Fourth hypothesis presents the association between board activity (frequency of meetings) and firm performance. Outcome of the result of hypothesis testing has failed to reject the null hypothesis. Therefore, it found that there is a positive association between the board activity and firm performance for the selected organizations under this study. Table 4 presents the outcome of all hypotheses briefly.

Table 4: Summary of Hypotheses Testing

No	Hypotheses	Test	Null Hypotheses	Findings
H1	There is a positive association between the board size and firm performance.	Regression Analysis	Failed to reject	Significantly positive association between the board size and firm performance
H2	There is a positive association between the proportion of outside directors in the board and firm performance.	Regression Analysis	Failed to reject	Significantly lower association between the proportion of outside directors in the board and firm performance
H3	There is a negative association between concentrated leadership structure and firm performance.	Regression Analysis	Failed to reject	Negative association between the concentrated leadership structure and firm performance
H4	There is a positive association between board activity (frequency of meetings) and firm performance.	Regression Analysis	Failed to reject	Significantly positive association between board activity and firm performance
H5	There is a positive association between multiple directorships and firm performance.	Regression Analysis	Failed to reject	Positive association between multiple directorship and firm performance

VII: DISCUSSION OF OUTCOME AND CONCLUSION:

The present study under the head of minor research project is conducted to evaluate the impact of board characteristics on firm performance of the selected listed Indian companies. In order to evaluate the aims and objectives of this study, five hypotheses have been formed. These hypotheses includes the relationship of firm performance with board size, proportion of outside directors, concentrated leadership structure, frequency of board meetings and multiple directorship held by the board members. Various board characteristics parameters are considered as independent variable for this study. As dependent variables, various financial ratios are considered which are; return on assets, return on capital employed, return on net worth and Tobin's q. the statistical tests adopted to test the hypotheses are correlation analysis and multivariate regression analysis with the help of SPSS. Based on data analysis and statistical tests, it has been concluded that the performance of the selected listed companies for this study has significant impact of various parameters of board characteristics.

The present study has examined the relationship between established western internal governance structures and financial performance using a limited sample of top listed Indian companies (Beverley, 2009). The findings further suggests that the board is an important element of corporate governance mechanism. Board of directors plays pivotal role in entire system and process of corporate governance. As found in present study and supported by many other researchers board characteristics are highly correlated with the performance of the organizations. Hence, it is very important for the organizations to adopt the best practices for the structure and mechanism of board within the organization. They should obey the best governance practices prevailing in the industry to positively improve the vision of stakeholders' wealth maximization approach. Further, agency theory of corporate governance also highlights the responsibility of board towards the shareholders wealth creation by following the best practices.

The results and findings presented in this study are subject to some limitations, which should be considered when interpreting the results. First, it should be noted that the analysis is exploratory. Further investigations, particularly considering the unique characteristics of Indian companies, and domestic corporate culture should be considered. Secondly, a limited number of parameters related to board characteristics and corporate governance are considered under this study. This limits the generalizability of the findings of the study. Other parameters like remuneration of board members, female directors in the board, nationality of the board members, educational and other qualifications, etc. are important parameters, which may affect the performance apart from the selected parameters for the present study.

Considering the limitations of the findings outlined above, the findings of this exploratory research added to the body of literature on corporate governance in growing economy like India. The findings have considerable implications for various stakeholders apart from the directors and public policy makers engaged in corporate governance in India. A sound understanding of corporate governance mechanism is very essential to all stakeholders related to the organization, which becomes possible through various research based on it. The researcher of this project is highly obliged to Indian Council of Social Science and Research (ICSSR) to promote and sponsor this research project.

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