РАЗДЕЛ 3 КОРПОРАТИВНОЕ УПРАВЛЕНИЕ В АФРИКЕ

SECTION 3 NATIONAL PRACTICES OF CORPORATE GOVERNANCE: AFRICA

THE RELATIONSHIP BETWEEN BOARD SIZE, BOARD COMPOSITION, CEO DUALITY AND FIRM PERFORMANCE: EXPERIENCE FROM GHANA

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Abstract

The paper examined board characteristics and its impact on the performance of non-financial listed firms in Ghana. Data covering 11 year period (1990-2001) was used and analysis conducted within the panel data framework. The study shows that most Ghanaian firms adopt the two-tier board structure and are largely non-independent. The regression results, though relatively mixed, confirm other studies and show that there should be a clear separation of the two critical positions of CEO and board chairman in order to reduce agency cost for enhanced firm performance.

Keywords: Corporate Governance, Firm-Performance, Tobin's Q, Ghana

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1. Introduction

The concept "corporate governance" has attracted various definitions. Metrick and Ishii (2002) define corporate governance from the perspective of the investor as "both the promise to repay a fair return on capital invested and the commitment to operate a firm, efficiently given investment". The implication of this definition is that corporate governance has an impact on a firm's ability to access the capital market. Metrick and Ishii argue that firm level governance may be more important in developing markets with weaker institutions as it helps to differentiate firms from each other. Cadbury Committee (1992) defines corporate governance as "the system by which companies are directed and controlled". According to Zingales (1998) corporate governance is "the complex set of constraints that shape the ex-post bargaining over the quasi rent registered by the firm". While we acknowledge that there are several definitions of corporate governance, for the purpose of this study, we define corporate governance as the systems, structures and processes put in place to ensure that there is a clear line of accountability and responsibility in a firm, aimed at ensuring that the firm operates effectively with a notable reduction in ambiguity regarding functions, responsibilities and duties.

One must point out that the concept of corporate governance has been a priority on the policy agenda in developed market economies for over a decade especially among very large firms. Further to that, the concept is gradually warming itself as a priority in the African continent. Indeed, it is believed that the Asian crisis and the relative poor performance of the corporate sector in Africa have made the issue of corporate governance a catchphrase in the development debate (Berglof and von Thadden, 1999). A number of recent studies show that good corporate governance increases valuations and boosts the bottom line. For example, a study by Gompers *et al* (2003) showed that companies with strong shareholder rights yielded annual returns that were 8.5 percent greater than those with weak rights. Related to that, it was also observed that the more democratic firms also enjoyed higher valuations, higher profits, higher sales growth, and lower capital expenditures.

Again, poorly governed firms are expected to be less profitably, have more bankruptcy risks, lower valuations and pay out less to their shareholders, while well-governed firms are expected to have higher profits, less bankruptcy risks, higher valuations and pay out more cash to their shareholders. Claessens (2003) also argues that better corporate frameworks benefit firms through greater access to financing, lower cost of capital, better performance and more favourable treatment of all stakeholders. The position has been stated that, weak corporate governance does not only lead to poor firm performance and risky financing patterns, but are also conducive to macroeconomic crises like the 1997 East Asia crisis. Other researchers contend that good corporate governance is important for increasing investor confidence and market liquidity (Donaldson, 2003).

1.1. Corporate governance in Ghana

In Ghana corporate governance has been gaining roots in response to initiatives by some stakeholders such as the Ghana Institute of Directors (IoD-Ghana), in collaboration with the Commonwealth Association of Corporate Governance, to address corporate governance in Ghana. Again, there have also been other initiatives designed to address corporate governance issues in the country. For instance, a study, conducted and launched by IoD-Ghana in 2001, pointed out that there is an increasing acceptance of good corporate governance practices by businesses in the country.

Notwithstanding the above developments, it must be indicated that more formal corporate governance structures and institutions are relatively not widespread though a number of laws provide for governance structures for companies in Ghana. These laws include:

- The Companies Code 1963 (Act 179), which provides for governance of all companies incorporated in Ghana;
- The Securities Industry Law, 1993 (PNDCL 333) as amended by the Securities Industry (Amendment) Act 2000, (Act 590), which provides among other things for governance of all stock exchanges, investment advisors, securities dealers, and collective investment schemes licensed by the Securities & Exchange Commission (SEC).

In the Companies Code, there is a deliberate attempt to streamline corporate practices in the country. For instance, the code stipulates a minimum of two directors for a company with no ceiling on the maximum number, whilst the Ghana Stock Exchange (GSE) Listing Regulations are silent on board size. With regards to board composition, there is no requirement under the Companies Code for the appointment of independent directors neither is there a provision for the balance of executive and non-executive directors. However, there is allowance for the interests of different stakeholders to be represented on a board. This is however a requirement under The Securities and Exchange Commission's Code of Best Practices on Corporate Governance (SEC Code) for the GSE. The Companies code in Ghana makes provision for the appointment of executive directors by allowing directors to hold concurrently with the office of director, any other office or place of profit in the company, except the office of auditor. In the case of board structure based on duality or otherwise of the CEO, Companies Code does not prevent the appointment of the same person to the two offices. The SEC Code on the other hand advocates for but does not insist on the two-tier board structure where the CEO is different from the board chairman. On the whole corporate governance structure development in Ghana have been somewhat modest, there is need for more advancements in corporate governance issues given the effect these have on firm performance.

Developing countries such as Ghana are now increasingly embracing the concept of good corporate governance, knowing it leads to sustainable growth. In Ghana a study by Mensah et al (2003) on corporate governance and corruption, it was revealed that poor corporate governance practices amongst a sample of surveyed firms resulted in corrupt practices and dealings with the government which firms were unwilling to disclose.

However, in the context of Sub-Saharan Africa, the issue has received very limited empirical attention. This present study provides empirical evidence on corporate governance and firm performance from the context of a developing economy. The paper specifically investigates the

relationship between various variables of corporate governance and performance of companies listed on the GSE during the eleven year period (1990 – 2001).

The rest of the paper is organized as follows: section two looks at the review of literature; section three is devoted to data and methodology, section four discusses empirical findings and section five draws conclusions, policy implications and offers suggestion for a new research focus.

2. Review of literature

There is no gainsaying of that fact that the principal-agent theory is generally considered as the starting point for any debate on the issue of corporate governance. Indeed, the theoretical underpinnings for the extant research in corporate governance come from the classic thesis, *"The Modern Corporation and Private Property"* by Berle & Means (1932). The thesis describes a fundamental agency problem in modern firms where there is a separation of ownership and control. It has long been recognized that modern firms suffer from a separation of ownership and control. They are run by professional managers (agents), who are unaccountable to dispersed shareholders (principals). This view fits into the principal-agent paradigm. In this regard, the fundamental question is how to ensure that managers follow the interests of shareholders in order to reduce cost associated with principal-agent theory? It is the responsibility of the owners to find, retain managers and also ensure that the managers pursue objectives in line with theirs in order to reduce agency costs.
Previous empirical studies have provided the nexus between corporate governance and firm performance (see Yermack (1996, Claessens et al., 1999; Klapper and Love, 2002; Gompers et al., 2003; Black et al., 2003 and Sanda et al (2003) with inconclusive results. Others, Bebchuk & Cohen (2004), Bebchuk, Cohen & Ferrell (2004) have shown that well governed firms have higher firm performance. The main characteristic of corporate governance identified in these studies include board size, board composition, and whether the CEO is also the board chairman.

While some contend that small boards are effective for enhanced firm performance (1993) and Lipton & Lorsch (1992), Yermack (1996), Eisenberg et al. (1998), Mak and Yuanto (2003), Sanda et al (2003), others hold the opposing view. Regarding board composition, while, some contend that it is important for a firm to have more inside directors, others are of he view that it pays to have a dominated by outsiders.

The positions of the CEO and the board Chairman have also been subjects for intense debate. Hence, the literature reveals a board structure typology, the one-tier system and the two-tier system. In the one-tier system the Chief Executive Officer (CEO) is also chairman of the board, whilst the two-tier system has a different person as the board chairman and is separate from the CEO. Fama & Jensen (1983) also argue that concentration of decision management and decision control in one individual reduces board's effectiveness in monitoring top management.. It has been noted though that the one-tier board structure type leads to leadership facing conflict of interest and agency problems (Berg & Smith 1978, Bickley & Coles 1997) thus giving preference for the two-tier. It is argued that agency problems tend to be higher when the same person holds both positions. Yermack (1996) argue that, firms are more valuable when the CEO and board chair positions are separate. Relating CEO duality more specifically to firm performance, researchers however find mixed evidence. Daily & Dalton (1992) find no relationship between CEO duality and performance in entrepreneurial firms. Brickley et al. (1997) show that CEO duality is not associated with inferior performance. Rechner & Dalton (1991), however, show using a sample of Fortune 500, that companies with CEO duality have stronger financial performance relative to other companies. Goyal & Park (2002) examine a sample of U.S. companies and find that the sensitivity of CEO turnover to firm performance is lower for companies without CEO duality. Sanda et al (2003) found a positive relationship between firm performance and separating the functions of the CEO and Chairman.

Considerable attention has been given to the role of boards in monitoring managers and in removing non-performing CEOs. Jensen (1993) voices a concern that a lack of independent leadership makes it difficult for boards to respond to failure in top management team. -tier system. Klapper and Love (2002) examine corporate governance and performance in a sample of firms in 14 countries, most of which are developing economies. They find that better corporate governance is associated with better performance in the form of Tobin's q and ROA and that good governance seems to matter more when the legal environment of a country provides investors with weaker protections. Thus, corporate governance is noted to have a significant impact on a firm's performance.

Though, corporate governance is considered to involve a set of complex indicators which face substantial measurement error due to the complex nature of the interaction between governance variables and performance indicators, the purpose of this paper is to examine the influence of selected corporate governance variables namely Board size (BDS), Board composition (BDC), and CEO duality (CEO) have on performance variables of Tobin's Q, (TOB), and Sales growth rate (SGR), giving due

recognition to some control variables such as the size of the firm (SZE), the asset structure (AST), and the Debt structure (DBT). The variables are carefully chosen because of data availability and measurement.

3. Data and Methodology

The study employs basically secondary data based on the financial statements of all the 16 listed non-financial firms on the Ghana Stock Exchange. The use of listed firms is due primarily to data availability and reliability because these are required by law to provide end of year financials. The banks and the other financial institutions are excluded because of their huge debt structure which is very much different from the other firms, consistent with studies by Faccio and Lasfer (2000). Data for the study covers the eleven year period from 1990 to 2001.

The governance data and variables were also obtained through the administration of questionnaire and personal interview. The methodological approach used in most previous work examining the impact of corporate governance on firm performance variables utilizes a multiple regression. Thus, the study employs a modified version of the econometric model of Miyajima et al (2003) which is given as follows:

$$Y_{it} = \beta_0 + \beta_1 G_{it} + \beta_2 C_{it} + e \qquad (1)$$

Where Y_{it} represents firm performance variables; Tobin's Q (TOB), and Sales growth rate (SGR), for firm i in time t. G_{it} is a vector of corporate governance variables; Board Size (BDS), Board Composition (BDC=number of outside directors/total number of directors), and a dummy variable (CEO) to capture if the board chairman is the same as the CEO or otherwise and e, the error term. C_{it} is a vector of control variables; Size of Firm (SZE), the ratio of Fixed assets to total assets (AST), and the Debt structure (DBT).

3.1. Variables and description

The variables for the study were chosen based on data availability and computational purposes.

3.1.a Firm performance variables

TOB=Tobin's Q with measurement shown in the appendix. ROA=this is defined as return on assets and is computed by dividing profits before interest and tax payments by total assets; SGR=Sales growth rate is calculated by dividing the difference between current sales and previous year's sales volumes by previous year's sales volume.

3.1.b Governance variables

BDS=this is the number of members serving on a firm's board; BDC=the board composition is the ratio of outside directors to the total number of directors (i.e. number of outside directors divided by total number of directors) CEO=this is a dummy variable which takes the value of 1, if the CEO combines as the board chairman and 0 if there are different people occupying the two positions of CEO and board chairman

3.1.c Control Variables

SZE= this is the size of the firm measured by the value of its asset base. For the regression analysis, we take the log of the assets because the values are widely spread; AST=this is the ratio of fixed assets to total assets in trying to measure how much of the assets base represent fixed and for that matter structures and equipment; DTB=this the debt structure of a firm measured by the total of debts (both short and long term) divided by the total assets. The essence of the control variables is to give recognition to the fact that the performance of a firm and for that matter listed firms may be influenced by several factors.

Both parametric and non-parametric methodology is employed. The regression is run in a panel manner; various options of panel data regression were run, fixed effects, random effects, OLS, GLS and a dynamic panel. The most robust of all was the GLS panel. Thus, we report results of the GLS panel regression in the subsequent tables.

4. Empirical findings

4.1. Descriptive statistics

Of the firms studied, the mean board size is about eight (8) suggesting that firms in Ghana have relatively moderate board sizes. With a maximum board size of thirteen (13) and deviation of 1.97, the implication is that firms in Ghana have relatively similar board sizes. The results also show that these boards are dominated by insiders indicated by 80.9% and 76% representing maximum and mean respectively being appointed from within. Again, of all the firms studied, 75% of them adopt the 2-tier board structure implying that about 25% of the firms have their CEOs and Board chairman positions combined in one personality. This suggests that avenue for agency problems emanating from conflict of interest are minimized.

Table 1. Descriptive statistics of dependent and independent variables

	Min	Mean	Median	Std. Dev.	Max.	Jarque-Bera	Kurtosis
BDS	5.0	8.22	8.0	1.79	13.0	35.72725	4.159571
BDC	0.091	0.239	0.231	0.1135	0.40	20.27343	1.571121
CEO	0.0	0.25	1.0	0.434	1.0	46.22222	2.333333
TOB	0.120	0.661	0.585	0.359	1.477	8.195276	2.410295
ROA	-0.70	0.201	0.197	0.195	0.69	23.66090	4.562505
SGR	-0.243	0.378	0.347	0.285	1.927	265.2342	8.077588
AST	0.015	0.268	0.514	24.575	0.867	285745.4	189.9821
SZE	10	13.33	12	4.12	32	1316.471	9.384385
DTB	0.096	1.134	0.772	5.048	70.187	268706.3	184.2857

With a mean performance ratio of 0.67, most of the firms appear not to be doing well with regards to Tobin's q as a performance variable. While the maximum performance is about 148%, the minimum performance is 12%. With regards to return on assets (ROA), there is wide deviation between firms. Showing a mean performance of 20%, the minimum reported performance over the period is -70% with a relatively high deviation of 0.195 between firms. Sales growth rate (SGR) appears relatively stronger with a minimum operating performance of -24%. Whiles the maximum sales growth rate is about 193%, the mean rate is about 38%.

Firms in Ghana have most of their assets in fixed assets shown by the descriptive statistics. The interesting issue however is that with a standard deviation of about 24.57, it suggests that most of these firms are widely dispersed in terms of their of fixed assets composition. The situation is further buttressed by the minimum and maximum values of 0.015 and 0.867 respectively.

All the firms studied are relatively of similar sizes shown by the value of their asset base and that most of the firms are dependent on more debt in their capital structure in financing their assets with a mean value of 1.13.

While the board composition, CEO duality, and Tobin's q appear normally distributed shown by their Jarque-Bera and Kurtosis values, the rest of the variables are somewhat leptokurtic (peaked).

4.3. Regression results and discussion

Table 2 shows the regression results of the relationship between Tobin's q (TOB) and the governance variables. The results clearly indicate that there exist a mixed result between the governance variables and this performance variable. Contrary to studies by Jensen (1993), Lipton & Lorsch (1992), Yermack (1996), the study show that the lager the size of the board, the better the Tobin's q. This confirms studies that support the view that larger boards are better for corporate performance because members have a range of expertise to help make better decisions, and are harder for a powerful CEO to dominate.

Similar to the board size, the board composition has a negative relationship with Tobin's q implying that when there are more external board members, performance of the firm tends to be worse. This contradicts other empirical studies by Brickley & James (1987), Weisbach (1988), Byrd & Hickman (1992), and Brickley et al. (1994), Baysinger & Butler (1985) and Rosenstein & Wyatt (1990). However, the finding is consistent with that of Agrawal & Knoeber (1996) who suggest that boards expanded for political reasons often result in too many outsiders on the board, which does not help performance. It must rather be indicated that this variable is not significant.

Relating to CEO duality, the results of the study suggests that the one-tier board typology is negatively related to Tobin's q. This is consistent with studies which have found out that the one-tier board structure type leads to leadership facing conflict of interest and agency problems (Berg & Smith 1978, Bickley & Coles 1997) thus giving preference for the two-tier system. Again, it has been argued that problems tend to be higher when the same person holds both positions. Yermack (1996) equally argues that, firms are more valuable when the CEO and board chair positions are separate. In the context of developing country, Sanda et al (2003) in a Nigerian study found a positive relationship between firm performance and separating the functions of the CEO and Chairman.

Contrary to expectation, the study suggests that the size of the firm has a negative impact on Tobin's q though not significant. This could however be explained by the fact that the size of a firm measured by its asset base does not necessarily enhance performance if this is not put to efficient use. The implication therefore is that most firms in Ghana are not utilizing their size to enhance their performance. This is because; the study shows that, the more fixed assets there are, the better the performance of Tobin's q. Thus, the descriptive results indicating a relatively widely dispersed asset structure (with few having higher proportion of fixed assets) is being confirmed.

The study again shows that firms that mostly have huge proportions of debt in their asset portfolio

perform better that otherwise. The significantly positive regression coefficient for total debt implies that, an increase in the debt position is associated with increase in performance. The results confirm findings by Hadlock & James (2002), Petersen and Rajan (1994) and Roden and Lewellen (1995), who posit that profitable firms use more debt. Again, this suggests that profitable firms depend more on debt as their main financing option. The result is presented in Table 2.

Table 2. Dependent Variable: TOBIN'S Q

White Herteroskedasticity-Consistent Standard Errors and Covariance.				
Variable	Coefficient	Std.Error	t-statistic	Prob.
BDS	0.099222	0.003828	25.91706	0.0000
BDC	-0.013756	0.110004	-0.125052	0.9006
CEO	-0.244850	0.044671	-5.481231	0.0000
LOG (SZE)	-0.003565	0.003337	-1.068437	0.2867
AST	0.000132	2.58E-05	5.112696	0.0000
DTB	0.008418	0.000745	11.29666	0.0000
C	0.064966	0.078067	0.832179	0.4064

Weighted Statistics.			
R-squared	0.864457	Mean dependent var	1.049009
Adjusted R-squared	0.860061	S.D dependent var	0.834732
S.E of regression	0.312260	Sum squared resid	18.03863
F-statistics	196.6475	Durbin-Watson stat	0.732216
Prob(F-statistic)			0.000000

Table 3 is the regression results of the interaction between sales growth rate (SGR) and the governance variables. The board size on this occasion is negatively related to sales growth. Indeed, this is consistent with studies by others, for instance, Jensen (1993) and Lipton & Lorsch (1992) who argue that large boards are less effective and are easier for the CEO to control. When a board gets too big, it becomes difficult to co-ordinate and process problems. Further argument is that smaller boards also reduce the possibility of free riding by individual directors, and increase their decision taking processes. Other empirical research supports this e.g. Yermack (1996). On board composition, the rate of growth in sales is negatively related to board composition. This result contradicts earlier studies that show that the more outsiders there are on a board, the more independent is the board and the better the performance of the firm, John and Senbet's (1998). As already mentioned, Agrawal and Knoeber (1996) point out that boards expanded for political expediency often result in too many outsiders on the board, which does not help performance. Regarding CEO duality, the results point to a positive relationship between the performance of firms in terms of SGR and the 1-tier board structure in which case the same person doubles as the CEO and chairman of the board. This is consistent with other empirical studies such as Fama & Jensen (1983) arguing that the concentration of decision management and decision control in one individual reduces boards' effectiveness in monitoring top management. It tends to increase agency costs, Yemack (1996), because it depicts a clear case of conflict of interest and agency problems, Berg and Smith (1978), Bickley and Coles (1997). Surprisingly, the results further indicate when a CEO doubles as the board chairman, performance improves. Though unexpected, this is not incongruous with studies that suggest that in the one-tier board typology, the CEO is afforded the opportunity to carry through projects deemed beneficial to a firm without undue bureaucracy It must however be pointed out that all these governance variables are not statistically significant in explaining SGR, though the board size appears somewhat significant. Expectedly, the asset structure, the size of the firm and the debt structure are all positively related to SGR. By implication, the finding suggests that firms in Ghana that rely on debt, with a huge composition of fixed assets in their portfolio tend to perform better likewise firms that have more debts in their capital structure. These variables, unlike the governance variables, are significant in explaining SGR. Thus, firms in Ghana should lean towards having more debts, and increase in size to enjoy economies of scale. The results in presented in the Table 3.

Table 3. Dependent Variable: Sales Growth Rate

White Heteroskedasticity-Consistent Standard Errors & Covariance.

Variable	Coefficient	Std. Error	t-statistic	Prob.
BDS	-0.014693	0.007743	-1.897544	0.0593
BDC	-0.143465	0.169234	-0.847734	0.3977
CEO	0.038780	0.031253	1.240864	0.2162
LOG(SZE)	0.010347	0.004400	2.351302	0.0198
AST	0.001295	7.01000	18.47214	0.0000
DTB	0.009483	0.001021	9.286916	0.0000
C	0.331298	0.093626	3.538512	0.0005

Weighted Statistics

R-squared	0.109657	Mean dependent var	0.420608
Adjusted R-squared	0.080781	S.D. dependent var	0.282991
S.E. of regression	0.280908	Sum squared resid	14.59820
F-statistic	3.797519	Durbin-Watson stat	1.752804
Prob(F-statistic)	0.001363		

5. Conclusion and new research agenda

The study examined the relationship between some measures of corporate governance such as board size, board composition, and CEO duality and firm performance of listed non-financial institutions in Ghana. The mean board size for the sample was found to be eight and the maximum thirteen with a moderate deviation of 1.79. With regards to board composition, the mean ratio of about 24% implies the use of more inside directors on the boards in the overall sample. Further implication of this is that boards in Ghana are not deemed independent consistent with argument by John and Senbet (1998). It is evident from the study that most firms in Ghana adopt the two-tier board structure where the positions of board chairman and CEO are occupied by different personalities thereby reducing agency cost. The firms are of similar sizes indicated by their asset base, fixed assets forms a major component of their total assets and that most of the firms depend largely on debt financing for their operations as against equity financing.

The regression results further show that board size is positively related to Tobin's q, but negatively related to sales growth rate as performance variables. This adds to the ongoing debate of how inconclusive the size of the board is on various performance measures. Though insignificant and surprisingly, the board composition conclusively have a negative impact on firms' performance in Ghana. Largely and like other studies, the findings of the study support the fact that a two-tier board structure enhances firm's performance, though it insignificantly has a positive impact on sales growth rate. The separation of board chairman and chief executive officer positions minimizes the tension between managers and board members thus influencing positively the performance of firms in Ghana.

The control variables show the expected signs. The study also show significantly that the more fixed assets there are in a firm's asset portfolio, the better the performance whiles firms that largely resort to debt financing as against equity financing perform better. The size of a firm showed an inconclusive impact on the firms' performance. It is obvious therefore that corporate governance structures have an impact on the performance of firms in Ghana. Indeed within the governance structures the two-tier board structure is seen to be more effective compared to the one-tier system.

In the light of the foregoing analysis, it is obvious that there is relatively mixed results regarding corporate governance and various performance measures among listed firms in Ghana. It must stated that this is consistent with other studies. However, for efficient performance of firms, the adoption of the two-tier board structure and maintaining smaller board sizes that hovers around eight members is critical.

Obviously the study buttresses the fact that corporate governance indeed embraces a broader set of variables such as economic and legal environment, progressive practices, existence of internal control measures, ownership and compensation structures within an institution, the nature and quality of information flow and the level of involvement of low level staff in the day to day decisions of a corporate entity. Thus, subsequent to this work, a look at the development of a corporate governance index for Ghana would be our focus.

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Appendix:

Tobin's Q is probably the most frequently used valuation measure in empirical corporate finance. Being named after the Nobel Price laureate James Tobin from Yale University, it is defined as the ratio of market value to replacement value of a firm's assets. As an approximation for measurement, the market value of assets is normally computed as market value of equity plus book value of assets, minus book value of equity. This is then divided by the book value of assets to obtain the Tobin's Q. this ratio is basically expected to be greater than unity as an indication that management has done well in its investment decisions.