

CORPORATE GOVERNANCE AND FIRM EFFICIENCY: THE ROLE OF BOARD COMPOSITION

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How to cite: Vacca, A., Iazzi, A., & Fait, M. (2019). Corporate governance and firm efficiency: The role of board composition. *New Challenges in Corporate Governance: Theory and Practice*, 362-367. https://doi.org/10.22495/ncpr_46

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Received: 31.07.2019
Accepted: 12.08.2019
DOI: 10.22495/ncpr_46
Keywords: Board of Directors, Corporate Governance, Performance, Board Gender
JEL Classification: G30, G32

Abstract

This paper investigates the role of a different composition of board of directors on firm's performance. The study is based on the analysis of 149 Italian listed firms over the 2011-2017 period. Our regression results show that size board, gender diversity, independent directors and CEO gender have a significant effect on firm's performance. This analysis uses as measure of firm's performance two accounting-based measures ROE and ROA and one market-based measure TobinQ. The study shows that gender diversity, independent directors and CEO gender are associated positively respectively with ROE, ROA and TobinQ, while size board is negatively associated with ROE and TobinQ.

1. INTRODUCTION

A good board of directors enables a company to reach economical and financial efficiency; it helps also to ensure equal support to the stakeholders (OECD, 2015).

The board of directors has a strategic role and it is a critical factor of the governance structure of the large firms. It has tasks of ratifying and monitoring management operations of the managers with the scope of having appropriate remuneration for the shareholders (Fama & Jensen, 1983; Khan, Muttakin, & Siddiqui, 2013; Rose, 2007).

Accordingly to the previous studies (Erhardt, Werbel, & Shrader, 2003; Evans & Dion, 2012), this research aims to investigate, on a time interval of six years, the characteristics of the board that affect the performance of a listed firm on the Milano Stock Exchange.

2. SHORT DISCUSSION ON THE EXISTING LITERATURE

The international doctrine on corporate governance presents different interpretative insights and it investigates the phenomenon in a broad sense. In recent years, the debate on the role played by governance mechanisms is constantly growing and it describes the structure of the board of directors as a critical factor that affects firm performance.

Recent empirical studies, show that some characteristics of the board of directors are positively associated with firm performance, such as: the presence of women within the board (Erhardt et al., 2003; Reguera-Alvarado, de Fuentes, & Laffarga, 2017), the presence of the independent directors (Barka & Legendre, 2017), the presence of a Big4 as independent auditor (Barako, Hancock, & Izan, 2006) and the presence of the CEO women (Khan & Vieito, 2013).

The literature shows that the size board and the dual role of the CEO are negatively associated with firm performance (Lin, Ma, & Su, 2009; Jensen, 1993; Evans & Dion, 2012).

Accordingly with the mentioned literature, we can develop the following research hypothesis:

1. Size board affects negatively firm performance.
2. The presence of women affects positively firm performance.
3. The presence of independent directors affects positively firm performance.
4. The presence of the CEO women affects positively firm performance.
5. The dual role of the CEO affects negatively firm performance.
6. The presence of a Big4 as independent auditor affects positively firm performance.

3. RESEARCH METHODOLOGY

The population under investigation and the financial data have been taken from the database *AIDA – Bureau Van Dijk* and it is made up of 149 listed firms on the Milano Stock Exchange.

In order to analyse a homogeneous group of firms, we have considered the units that hold shares in at least one foreign subsidiary in countries other than Italy in the 2017 financial year.

The analysis carried out used a mixed method. We have used the research methodology "Document Analysis"; this research method is based on the evaluation of public documents characterized by stability

and exactness of the data (Bowen, 2009) in order to detect the characteristics of the board of directors.

We have chosen this methodology to comply with art. 123-bis of D. Lgs n. 58/98 of the Italian legislation, which forces companies to communicate the information about the composition of the board of directors and the ownership structure.

To investigate the relationships between firm performance and the composition of the board of directors, we adopted a panel data with fixed effects on a time interval of 6 years (2011-2017) with the determination of 894 overall observations.

4. REGRESSION MODEL

This study measures firm performance through three dependent variables: *ROA*, *TOBINQ* and *ROE*.

ROA is calculated by the ratio of net profit to the total assets. ROE is calculated by the ratio of net profit to net assets. TobinQ is calculated as the market value of equity plus the book value of debt divided by the book value of total assets (Faccio & Lasfer, 1999; De Andres, Azofra, & Lopez, 2005).

Accordingly to the previous studies (Khan & Vieito, 2013; Erhardt et al., 2003; Beasley, 1996) the independent variables *SIZEB*, *%WOMAN*, *%INDCONS*, *CEODUAL*, *CEOW*, *BIG4* represent the internal and external characteristics of a board of directors of a listed firm.

The control variables of this study are represented by *SIZET*, *SIZEM*, *LEV*, *R&D* accordingly to the previous studies on corporate governance and firm performance (Paniagua, Rivelles, & Sapena, 2018; Khan & Vieito, 2013; Erhardt et al., 2003).

Table 1. Description of the variables

<i>Code</i>	<i>Variable</i>	<i>Value</i>
ROA	Return on assets	%
ROE	Return on equity	%
TOBINQ	Firm value	Log
SIZET	Total assets	Log
SIZEM	Number of Employees	Log
LEV	Leverage	%
R&D	Research and development costs	Log
SIZEB	Size of the board	Log
%WOMAN	Percentage of woman	%
%INDCONS	Percentage of independent directors	%
CEODUAL	Dual role of the CEO	1=Yes
		0=No
CEOW	CEO Woman	1=Yes
		0=No
BIG4	Independent auditor: PWC, Deloitte, KPMG, EY	1=Yes
		0=NO

In order to analyse the relationship between the firm performance and the structure of a board of directors, we have estimated the following multiple linear regression models for each dependent variable.

Model 1:

$$ROA_{it} = \alpha_{it} + \beta_{1t}SIZET_i + \beta_{2t}SIZEM + \beta_{3t}LEV + \beta_{4t}R\&D + \beta_{5t}SIZEB + \beta_{6t}\%WOMAN + \beta_{7t}\%INDCONS + \beta_{8t}CEODUAL + \beta_{9t}CEOW + \beta_{10t}BIG4 \quad (1)$$

Model 2:

$$TOBINQ_{it} = \alpha_{it} + \beta_{1t}SIZET_i + \beta_{2t}SIZEM + \beta_{3t}LEV + \beta_{4t}R\&D + \beta_{5t}SIZEB + \beta_{6t}\%WOMAN + \beta_{7t}\%INDCONS + \beta_{8t}CEODUAL + \beta_{9t}CEOW + \beta_{10t}BIG4 \quad (2)$$

Model 3:

$$ROE_{it} = \alpha_{it} + \beta_{1t}SIZET_i + \beta_{2t}SIZEM + \beta_{3t}LEV + \beta_{4t}R\&D + \beta_{5t}SIZEB + \beta_{6t}\%WOMAN + \beta_{7t}\%INDCONS + \beta_{8t}CEODUAL + \beta_{9t}CEOW + \beta_{10t}BIG4 \quad (3)$$

5. RESULTS

The multiple linear regression model evidences that the firm value is affected positively by presence of CEO women and negatively by size board.

Furthermore, the analysis shows as ROA index is affected positively by the presence of independent directors within the board.

Lastly, we note a positive relationship between ROE index and the presence of the women within the board and a negative relationship between the same index and size board.

6. MANAGERIAL IMPLICATIONS

This study offers important managerial implications and it contributes to the existing literature in different ways. In particular, the work shows a negative relationship between size board and two of three indexes as measures of firm performance. This data suggests that a smaller board could be characterized by group cohesion in order to bring benefits in strategic terms for a firm.

Furthermore, the positive relationship detected between the presence of the independent directors within the board and firm performance suggests that the degree of independence of these directors could be relevant in strategic terms for a firm. This grade allows the independent directors to take objective decisions in the interests of a firm.

Another aspect showed by analysis, as the positive association between the presence of CEO women and the firm value enriches the debate empirically unexplored on this figure.

Finally, the positive relation between the presence of the women within the board and firm performance enriches the existing literature. This data suggests as the women within the board could be relevant in the decision-making process of a firm.

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