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THE EFFECT OF BOARD CHARACTERISTIC ON FIRM FINANCIAL PERFORMANCE

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ABSTRACT

The currently business environment is characterized by uncertainty and risk, making it increasing difficult to forecast and control the tangible and intangible factors which influence firm performance. The performance of an organization depends on its governance, directors and their attitudes. Therefore should be more attention corporate governance. Among corporate governance characteristics board characteristics take major place. The study explores the effect of board characteristics on firm financial performance of listed companies in Colombo Stock Exchange (CSE) during the period of 2015/2016-2016/2017. The research employs 100 listed high turnover companies for the study. Measures of board characteristics employed in this study are Board size, Education qualification, Director Independence and Female direction proportion. Also this study employed Return on Assets as the measurement of the firm financial performance, and employed firm size as control variables. The data were analyzed and hypotheses were tested through descriptive statistics, correlation analysis and regression analysis by using SPSS. The findings revealed that, board size has negative significant influence on company performance. And also women direction proportion has negative and no significant influence on company performance. Director's independent has positively not significant influence on firm performance. And also education qualification has positively not significant influence on firm performance. And also among control variable firm size has significant positive impact on financial performance.

Keywords: Board Characteristics, Financial Performance, Colombo Stock Exchange.

INTRODUCTION

All Sri Lankan companies have been considering their corporate governance with regard to increase their wealth in firm. . Corporate governance is the system by which companies are directed and controlled (Cadbury, 1992). And also corporate governance can be identified as system of rules, practices and processes by which a company is directed and controlled. Corporate governance essentially involves balancing the interests of the many stakeholders in a company. These include its shareholders, management, customers, suppliers, financiers, government and the community. Since corporate governance also provides the framework for attaining a company's objectives, it includes practically every area of management from action plans and internal controls to performance measurement with corporate disclosure. Boards are main element of corporate governance. They are expected to perform different function such as monitoring of management, hiring and firing of management, proved and give access to resources, providing strategic direction for the firm. According to past literature as identified the element of board characteristic, independence of the board, board size, Female director proportion, education qualification, accounting expertise of directors, board meeting, director ownership, CEO duality, non-executive directors are substitutable etc. this study examine four characteristic there are board size, board independence, female director proportion, education qualification. Firm performance is act of performing of doing something successfully, using knowledge as differentiated from only possessing it they, and all so criticized his performance as experience generally improves performance. Performance can be measured return on assets and return on equity. There are different factors effects to financial performance of a firm. Among them board characteristics play a major role. Therefore, his research focused on to find, the effect of board characteristics on firm financial performance collecting data from top 100 companies listed in Colombo Stock Exchange period from 2015/2016 and 2016/2017.

PROBLEM STATEMENT

The performance of an organization depends on its governance, directors and their attitudes. Therefore directors and characteristic friendly within the organization and while this situation organization can be achieved their goals and objectives effectively and efficiency. Corporate governance including the guidelines rules and a practice by a company try to finds achieves its objectives of stockholders. Board of characteristics has been largely criticized for the decrease in shareholders wealth and corporate failure. Some of the reasons stated for this corporate failure are the lack of helpful mistake functions by the board of directors, the board resigning control to corporate managers who follow their own self-interest sand the board being remiss in its accountability to stakeholders. Further, Researchers have used many different theoretical points of view to evaluate the effect of board characteristics on firm performance. But, a common aim of different theories has been to establish a link between various board characteristics and firm performance, Kiel & Nicholson, (2003). Importance of boards in corporate governance studies was underscored by Monks & Minow (2004), who refer to corporate governance as the relationship amongst shareholders, the board of directors, and senior management, and how the strategic decisions that are critical for the success of a business. According to Monks & Minow (2004), found that board membership, its organization and its function, effects significantly on firm performance. Therefore, this study is an attempt to investigate is there any "Relationship between board characteristic and firm financial performance" by considering listed companies in Sri Lanka.

RESEARCH OBJECTIVES

The main objective of the study is to find out the impact of board characteristic on firm financial performance of listed companies in Sri Lanka. The following sub objectives are considered for the above purpose.

Sub Objectives

1. To determine relationship between board size and firm performance listed companies in Sri Lanka
2. To determine relationship between independent directors and firm performance listed companies in Sri Lanka
3. To determine relationship between female director proportion and firm performance listed companies in Sri Lanka
4. To determine relationship between education qualifications and firm performance listed companies in Sri Lanka

LITERATURE REVIEW

Accoring to Lipton & Lorsch (1992), Jensen (1993), Yermack (1996), small board size contributes more to the success of a company. Furthermore, Yermack (1996) argued that large board is slow in decision making and time wasting. According to Klein (1998), larger board size enables board to gather more information. However, the number of directors on board seems to have influence on firm performance and also reported positive relationship between board size and leverage. According to Yermack (1996), there is an inverse relationship between board size and firm value. Adams & Mehran (2008), found that there is a positive relation between board size and Tobin's Q. they argue that this finding reflects the increase in board size is attributed to more recurrent merger and acquisition activity in the U.S. banking industry. Lipton & Lorsch (1992), found that beyond some point having more directors on the board will lead to a lower level of corporate performance. Board independence refers to a corporate board with common of outside directors. The reason is that shareholders interest could be well protected by outside directors than then the inside directors. For independent directors to perform their duties well they must be free from management's influence. The effective monitoring by independent directors reduces agency costs and increase company performance, Fama (1980). Abidin (2009), Found evidence that a higher proportion of independent non- executive directors on the board have a positive impact on firm performance base on value added intellectual coefficient measurement. This study addresses and investigates the conflicting issue of whether a high performance of an organization. According to Rosenstein & Wyatt (1990), Reported that the appointment of additional independent directors on board composed mostly of independent directors' results in an increase in firms' value. Furthermore, Peng (2004), investigates whether the appointment of independent directors in a given year is affected by the prior poor performance of the firm and prior firm's size. Bonn (2004), discovered a positive relationship between financial performance and presence of female directors in the board. The women participation in all most all the activities around the world is increasing. Labor force participation bearing managerial posts, appearance in politics is some of the activities that the women take part actively at an increasing trend in the present day. As a result the composition of board may not be able to disregard the women representation. According to Catalyst (2010), women hold about 15 of board seats in Fortune 500 companies is 2010, while they also occupied 9.4 board seats of French companies. Women on board can increase effectiveness of board control as they are more strict and trustworthy than their male counterparts. Their participation in board governance can help to avoid risky projects as they are generally more financial risk averse then men, Baysinger & Hoskisson (1990). According to Carter, Simkins, & Simpson, (2003) found positive significant relationship between women directors and firm performance. Further Smith, Smith, & Verner, (2006) found significant effect of women on firm performance while Adams & Ferreira, (2009) found negative significant relationship. According to Darmadi (2011), found a negative effect of female directors on both ROA and Tobin's Q. Minguez-Vera & Martin, (2001) found a significant negative relationship between female directors and firm performance measured by ROE using simple of small and medium Spanish enterprises from 1998 to 2003. Similar results were obtained from study of Rose, (2007) and Marinova, Plantenga,

& Remery, (2010). Furthermore, Akpan & Amran, (2014) feature of the result is that the finding that board women had a negative significant influence on company performance.

Educational qualifications are included in the guide for evaluating corporations' faithfulness to corporate governance. Qualifications of individual board members are important for decision making. For example, the monitoring role can be effectively implemented if the board members are qualified and experienced. Since the resource dependency perspective, qualified and skillful board members can be considered as a strategic resource to provide a strategic linkage to different external resources Ingley & Walt (2001). Board members with higher qualifications would ensure an effective board, which requires, "high levels of intellectual ability, experience, soundness of judgment and integrity", Hilmer (1998). Accroding to Carpenter & Westphal (2001), Boards members with higher qualifications benefit the firms through an increase of kwon and capabilities which helps in creating a various perspectives to decision making.

H1: There is a negative relationship between board size and firm performance listed companies in Sri Lanka

H2: There is a positive relationship between directors independent and firm performance listed companies in Sri Lanka

H3: There is a negative relationship between Female Director Proportion and firm performance listed companies in Sri Lanka

H4: There is a positive relationship between Education qualification and firm performance listed companies in Sri Lanka

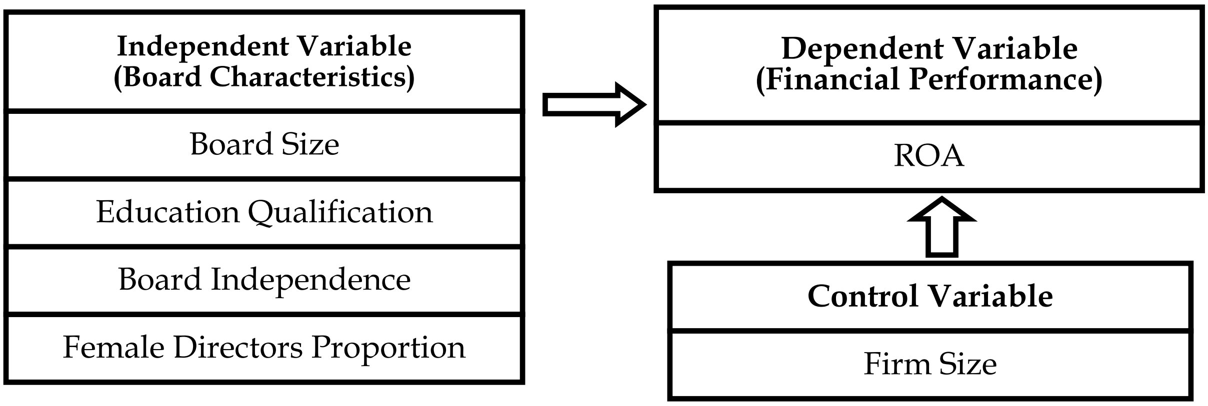
POPULATION, SAMPLE AND DATA COLLECTION

Target population for the study considers the all listed companies of Colombo Stock exchange (CES). CSE is including 289 companies with 21 sectors. Based on turnover selected top 100 companies and considered the period of 2015/2016 to 2016/2017. The Data was obtained from secondary sources.

CONCEPTUAL MODEL

In this research to identify, measure, and identify relationship between board characteristic used as independent variables are board size, female directors proportion, directors independent, education qualification and dependent variable Return on Assets (ROA) are used to measure the performance of the company.

Figure 3.3.1 Conceptual Framework



Source: Survey data 2018

VARIABLES AND MEASURES OF VARIABLES

ROA used to measure the financial performance (Dependent Variable) of the company. Calculated net income divided by Total assets, multiplied by 100 as percentage. Independent variables include Board size (the total number of members in the Board of Directors (inclusive independent directors) attending the annual meetings held during each financial year, Education qualification (the proportion of number of members with MSC and MBA to the Board size), Director Independence (the proportion of independent directors to the Board size) and Female direction proportion (the proportion of Female direction to the Board size). Firm size considered as the control variable of this study and used natural log value of sales value to measure it.

Research Model

$ROA = \alpha + \beta_1 BS + \beta_2 WDP + \beta_3 DI + \beta_4 EQ + \beta_5 FS + \varepsilon i$

ROA - Financial performance

BS - Board Size

WDP - Women Director Proportion

DI - Director Independence

EQ - Education Qualification

FS - Firm Size (Sales)

α - Constant

$\beta 1$ - Parameter

εi - Error Term

DATA ANALYSIS & RESULTS

Descriptive Statistics

Table 1: Descriptive Statistics

	Minimum	Maximum	Mean	SD
ROA	-11.105	60.262	6.910	9.808
BS	5.000	16.000	9.030	2.219
WDP	0.000	0.563	0.092	0.108
DI	0.000	0.900	0.346	0.153
EQ	0.000	0.875	0.280	0.156
FS	13.406	25.217	21.805	2.122

Source: Data Analysis

According to table 1 mean value of ROA 69.1 percent. It implies that assets 69.1 percent return gained using total assets of the company. Maximum value of ROA is 60.26, minimum value is -11.105. Standard deviation is 9.808.

Correlation Analysis

Table 2: Correlation Analysis

	ROA	BS	WDP	DI	EQ	FS
ROA Sig.(2- tailed)	1					
BS Sig.(2- tailed)	-.213** .007	1				
WDP Sig.(2- tailed)	-.092 .250	.176* .027	1			
DI Sig.(2- tailed)	.112 .159	.248** .002	.082 .303	1		
EQ Sig.(2- tailed)	.169* .034	.086 .285	.074 .352	.252** .001	1	
FS Sig.(2- tailed)	.173* .030	.148 .063	.137 .085	.036 .650	.080 .320	1

According to above table there is a negative significant relationship between board size and financial performance. And also there is a positive significant relationship between educational qualification and financial performance at 0.05 significant levels. In addition to that there is a significant positive relationship with firm size and financial performance at 0.05 significant levels.

Regression Analysis

Table 3: model summary

Model	R	R Square	Adjusted R Square	Std. Error the Estimate
1	.340[a]	0.115	0.086	9.375

Predictors: (constant) FS, DI, WDP, EQ, BS

According to above table R^2 value is 11.5 percent. It implies that 11.5 percent variation in firm financial performance is represented by board characteristics considered in this study.

Table 4:ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1741.618	5	348.324	3.962	.002
	Residual	13361.309	152	87.906		
	Total	15103.309	157			

a. Predictors: (Constant), S, DI, WDP, ED, BS
b. Dependent Variable: ROA

Table 5: Coefficients[a]

	Unstandardized coefficients		Standardized coefficients	t	Sig.
Model	B	Std. Error	Beta		
1 (constant)	-8.348	8.433		-0.990	0.324
BS	-0.902	0.359	-0.204	-2.515	0.013
WDP	-8.879	7.127	-0.098	-1.246	0.215
DI	2.883	5.252	0.045	0.549	0.584
EQ	8.192	4.978	0.131	1.646	0.102
FS	0.960	0.360	0.208	2.663	0.009

a.Dependent variable: ROA

According to above table, board size has significant negative relationship with financial performance. Women director proportion has negative effect on financial performance, but it is not significant. Director independence and educational qualification has positive impact on financial performance, but it is not significant. Firm size has positive and significant relationship with financial performance.

HYPOTHESIS TESTING

Table 4.6 Hypothesis Testing

Hypothesis	Expected	Actual	Accepted or Reject
There is a negative relationship between board size and firm performance.	Negative	Negative	Accepted
There is a positive relationship between directors independent and firm performance.	Positive	Positive	Accepted
There is a negative relationship between women direction proportion and firm performance.	Negative	Negative	Accepted
There is a positive relationship between education qualification and firm performance.	Positive	Positive	Accepted

CONCLUTION & RECOMMENDATION

Main purpose of the study is to identify whether there is a relationship between board characteristic and firm performance related listed companies in Colombo stock exchange. Researcher selected top listed companies base on turnover. This study has focused on analyzing the relationship between board characteristic and firm performance. Board size, women direction proportion, Direction Independent and education Qualification were taken as the variable of the board characteristics. It is independent variable. ROA ratio was taken as the measure of firm performance. It is dependent variable. A sample of 100 companies in the Colombo stock exchange was drowning from a period 2015/2016 and 2016/2017. Result from this study shows that bard size has negative significant influence on company performance. Another feature of the result is that the finding that women direction proportion has negative and no significant influence on company performance. Director's independent has positively not significant influence on firm performance. And also education qualification has positively not significant influence on firm performance. So, it can be recommend that, increase number of board of directors it causes to increase expenditure related to directors therefore suggested board size reduce to increase to firm performance. When consider independent directors it helps to increase performance of the firm therefore suggested better to increase independence directors of the firm. Hire directors for the firm should consider their higher education qualification as well as organization should implement encouragement activities. Proper training program should implement for the directors regarding maximization of the firm performance.

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