THE IMPACT OF BOARD COMPOSITION ON FIRM'S PERFORMANCE

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ABSTRACT

The objective of the study is to investigate the impact of board composition on firm's financial performance. A case of Pakistani listed companies a modal consist 18 organizations at KSE from the year ended from 2008 to 2012. In this study bank performance can be measured by using the return on equity and return on assets as performance techniques. A model consist 18 non financial organizations at KSE form the year ended 2008 to 2012 is selected. Which have independent board of director in their board, were scrutinize higher return on assets (ROA) and Tobin's Q.

Keywords: Board Composition, Firm's Performance, Pakistan.

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1. Introduction

Corporate governance is a mechanism used to control and direct the affairs of a corporate body in order to serve and protect the individual and collective interests of all its stakeholders. Corporate governance is a system by which organization's are directed and controlled (Cadbury, 1992). Corporate governance is a mechanism through which stakeholder's protect themselves against expropriation by the insiders (La Porta, 2000). It is the framework by which the interests of various investors are balanced. Today every organization has taking more crucial steps for board composition for better performance of the working activities. This is reality that the board composition put some bilateral effects on the process of business cycle. Effects include positive as well as negative effects. It is highly accepted by firm's organizers that board composition improve the corporate governance that is why we can say that performance of firms connecting by the these two factors. There are many different scope of board composition and corporate governance just like size of board, audit committee, Chief executive officer (CEO), duality and ownership structure, time schedule, frequency of the meetings etc. which is analysis by ancient researchers.

The basic objective and ambition of this study to describe the relationship between the firm's independent members and the performance .This study also analyzed and studied by various experts and researchers (Amir Khan and Dr Sajid Hussain Awan, 2012), (Gull et al., 2013), (Masulisa et al., 2012), (Becagli et al., 2013), (Atiqa Rehman and Ali Shah, 2013) and (Rashid, 2009) but these results oppose with one and other .Moreover Some researchers (Rashid et al., exposed that Independent board can not improve the performance of firm because his study shows that the negative relationship between the performance of firm and independent firm's board members. As a result the current studies attempt to the uncertainty prevailing in previous studies and re-examine the relationship between board and performance of firm.

The board director the source of the firm who perform the various tasks that improve the performance of the firm. Whether the decision related to the internal and external matter of the business it is perform by board directors and members. So not only they take the decision regarding the internal and external matter of the firm but they make the strategy to solve it and also elaborate how it will be solve it in better way. This is not always possible the independent board members perform well. Sometimes this prediction could be fail and show the negative relationship between outside or independent board director and firm's performance. In Pakistan both situation exiting in firms, some have independent directors and also perform always well but variation exit in little bit firms which have independent firms but not perform well. So there is possibility of positive and negative relationship between independent board of directors and performance of firm. But this study focuses on positive relationship between two factors and variable. The current study also focuses at negative relationship between these two variables. It also explains the conflict among positive and negative relationship. Moreover this study exclusively addresses the case of Pakistani companies. This study informs and provides some technical aspects and some new policy which is deeply impact on the business process such as from beginning to boom and then till depression. More it discusses the worth of the study The argument moves on to the appropriate analysis, broad and specific problem area, aim and the objectives of that study, the opinion and recommendations and research questions.

1.1 Importance of the Study

The current study shows the positive relationship between firm's performance and board independent members. But there are so many researchers who believed that there is negative relationship between these two factors. The major significance of this study is that to verify the conflicting factor between positive and negative relationship. The important factor of this study is that how positive relation is always existing in the firm which have independent board member. The major thing is after this study we are capable to understand how we improve the board composition and enhance the firm's performance. Furthermore this study provides how independent boards perform matter in better way and also indicate that in what manners it is better or not. The main significance of current study is how we improve the board composition of firm as well as how board composition improves the firm performance.

1.2 Objectives of the Study

The basic objective of this study to clarified that the firm's independent directors and firm's performance have positive relationship among each other. The other objective is to explain the other firms which have believed that the independent board members does not influence and enhance the efficiency or performance of the firm or company according to the some researchers (Rashid et al., 2010) and (Becagli et al., 2013). This study another purpose is to investigate, can age and gender diversity affects the firm performance or not.

1.3 Research Questions of the Study

There are following objectives and research questions of this study such as;

1. To analysis that in what way firm's performance and independent board members correlated with each other.
2. To verify how independent board members perform better than the dependent member.
3. To investigate how firm performance is interrelated with board composition.
4. To examine that how much this factor implement in the listed firms of Pakistan.
5. To analysis that how much board composition affects the several departments' performance of firms in Pakistan

2. Literature Review

(Amir Khan and Dr Sajid Hussain Awan, 2012) Effects of board composition on firm performance also verified by him much briefly, so I found during my literature review this that the performance is depends on firm's independent members. He conduct 91 listed firm's data and analysis how performance linked with Independent members of firm. This study shows positive relationship between these two variables. It is concluded that those firms which were having such situation get more efficiency in business activities such as return on Equity and enhance profit.

(Gull et al., 2013) his study examined the influence of board independence on baking performance of Pakistan over the period of 2007 to 2011. He conducts some firms from Karachi stock exchange for study purpose. He used some technique for measured the relationship between two variables such as correlation and regression analysis which is most appropriate techniques to find out the results. According to this study Outcome there is positive relationship among board of independent members and performance of banking activities. Due to independence of board members Return on Assets Earnings per share will be enhanced. So those firms which have independent board members have a better performance in financial transactions than the dependent board members.

(Masulisa et al., 2012) they examine the full employment histories of independent directors at S&P 1500 companies. They define an independent expert director or independent director with industry experience (IDIE) as an independent director. From the abstract of this study the independent board directors with industry experience (IDIE) has enhance the firm performance. According to their Outcome performance and Independence of directors are positively correlated with each other.

(Atiqa Rehman and Ali Shah, 2013) examine the relationship between the board independence and performance of listed firms at KSE for the period of 2005-2009. Performance is evaluated with the help of market based and accounting based performance measures. Many ratio and Tobin's Q are used as estimators of market performance, while ROA, has been used as accounting performance estimators. This study found that there is positive relationship among independence activities of board members and firm performance.

(Rashid et al., 2010) their study examine the pursuit of corporate board in the form of depiction of outside independent directors on firm is economic performance in Bangladesh. Two hypotheses are arranged to examine the relationship among composition of board memberships including independent directors and performance of firm. An examination of 274 Bangladeshi firm-years is used in the study. A linear regression analysis is used to test two hypotheses. Results reveal that the outside independent directors cannot add prospective value to the firm's economic performance in Bangladesh. So this study shows Negative relation among two variables.

Rashid (2009) this study examines that the corporate board composition in the form of representation of outside independent directors and structural independence of the board influence the firm economic performance in Bangladesh. By using 2-stage least square regression analysis it is found that performance of firm independent on the independent board members. According to this study outcome it is clear that the performance of organization have a positive correlated with Independent Board members.

(Francis et al., 2012) According to their analysis at board of independent directors of various firms they conclude that their better way of working always affects the business performance.

They also indicate that according to our traditional thinking the independent board members had never effects the firm performance because they had no any proper definition of the independent members. They redefine it that the outside directors are called the independent directors of firm. They also indicate this factor that performance of the firm and independent board of directors have positive relationship.

(Durer et al., 2009) the basic ambition of this study is that the age diversity of board directors can affected to firms performance. For this purpose they conduct some information regarding to their study from ISE 100 firms. They conclude that more than thirty nine (39) firms have no female directors because they perform less efficiently than the male director. They also one more factor observed during their study the age diversity also affect to the firm performance, the young directors gave less effective results as compare to the older director of the firm because the experience galvanized the firm performance. So according to this study the Independent director which also older and has well experience have positive relationship with firm's performance.

(Becagli et al., 2013) this study observed from the conducted information by the united state's various companies which have the independent board of directors. According to their study the independent board director have no influence on the firm performance because the outside or independent directors have less information regarding to the business whether the information related to the past or future of the companies. The independent or outside director have less knowledge about the firm's matter that's why they are fail to perform the business matters with better way. So we conclude that the outsider or independent directors have negative relationship with influential performance.

3. Data and Research Methodology

Methodology is technique to provide information of populace and sample selected for the study. Its section show that which sample is apply and used in the current research.

Furthermore it discusses the type of current study, the strength of the research and data collection and analysis techniques used in current study In order to fulfill the objectives of study secondary data acquired from financial statements. In the model the performance of firm was taken a dependent and independent variable. In the model the panel data of 15 firms's selected on convenient sample method and available data. Firm performance was taken dependent variable and independent variable. Descriptive statistics is the description of a selection of a data. Its aim to summarize a sample not uses the data of whole population. Measuring a central tendency including mean, median, mode and dispersion include range, standard deviation and variance.

Karachi stock exchange or KSE is a stock market. In Pakistan it is largest stock exchange market. In 1947, Karachi Stock Exchange is the biggest and most solid exchange in Pakistan. It was confirmed the "Best Performing Stock Market of the World for the year 2002". A total of 654 companies were listed on the 34 sectors. In order to fulfill the objectives of study secondary data acquired from non financial firms. Time period is taken from 2008, 2009, 2010, 2011, and 2012. The sample size is 15 companies listed in the Karachi stock exchange. We use panel data from individual firm's annual reports sheet to empirical assess whether which in any relationship among independent board and performance of firm if any relation moreover independent board return greater performance of firm or not and how independent board result on performance of a firm in Pakistani listed companies.

The independent variable or independent board was used as exact variable and the board Composition was classified in two categories, which were its two components independent and dependent board.

3.1 Tool and Components of Measurement

Ratio analysis is used to analysis the financial performance of the firms. Ratio analysis is used to Calculate the relationship between various variables. Ratio analysis is very useful to evaluate the firm's financial position and operations, by using these ratios making the comparison with previous years and further investigate easily.

Firm's performance was evaluated throughout the following components; Dependent variables are for firm's performance.

(ROA) Return on Asset

Return on Assets (ROA) = EBIT (Net profit) / Average total Assets - in book value -

Tobin's Q = Market value of equity + Book value of debt/total of assets - in book value

3.2 Explanation of Variables

Variable is a factor which shows that change in one variable effect the value of another variable. There are two types of variables, dependent variable and independent variable.

3.3 Dependent Variable

It dependent on the change in the independent variables if any change occurs in the independent variable it also shows the change in the others. The dependent variable is firm performance to measures the firm performance three different dependent variable are used Return on asset (ROA), Tobin's Q. ROA measure the firm ability to generate profit by utilizing its assets. Profit compare with the asset that how much an asset generate the profit. Tobin's Q provides market value of a firm or asset value of firm information about the price value of shares of a firm to make analysis as compared to other investments Tobin's Q a technique to estimate a firm's market value and its assets value so any investor or stakeholder can estimate any firm market value through this technique.

3.4 Independent Variable

The independent variable is a variable that is varied and changed by the researcher. Any changes in the independent variable also show the changes in dependent variable. The independent variable is board composition which consist further two components that are dependent and dependent board. Independent board is a board member which has no blood relatives and act of family and second one the dependent board member is salaried person who provide the services to the origination.

3.5 Theoretical Model Along With Hypotheses

Base on the previous part, this part discuss the speculative model of "The impact on firm's Performance from board composition. The model shows the link between dependent variable of firm performance and independent variable of board and shows its two components Dependent and Independent board or variable. Furthermore it also indicate the apparatus or components performance of firm such as ROA, Tobin's Q and their task the measure such relation among independent and dependent variables moreover this Section discuss different hypotheses that are to be practiced in current research.

Research Hypotheses

H1: which Companies heaving Independent board composition show greater ROA, which as a result show that better firm's performance

H2: which Companies heaving Independent board composition show greater Tobin's Q, which as a result show better firm's performance

4. Results & Discussion

4.1 Descriptive Statistics

Table No1 the descriptive statistics used to find out the normality of given data the table shows descriptive statistics that used to calculate Mean, Standard deviation, Median, variance, minimum and maximum, Skewness, Kurtosis Jarque Bera, and Probability of the given data and results indicated that mean values of BD, BI, ROA, TQ. 0.378378, 1.310811, 15.04027 and 2334075 respectively moreover the standard deviation of these variables are 0.488293, 1.403769, 14.78146 and 3151009 respectively. Moreover Skewness is a measure of regularity or more accurately, the lack of symmetry. The allocation and data set, is symmetry if it look the similar to the left and right of the axis position. Kurtosis is determine of whether the data are pointed or plane relative to a normal distribution.

Table 1: Descriptive Statistics

	BD	BI	ROA	TQ
Mean	0.378378	1.310811	15.04027	2334075
Median	0	1	11.765	923591
Maximum	1	6	58.23	13144909
Minimum	0	0	-19.53	95782
Std. Dev.	0.488293	1.403769	14.78146	3151009
Skewness	0.50155	1.61866	0.597532	1.950669
Kurtosis	1.251553	5.790757	3.568536	5.652931
Jarque-Bera	12.52844	56.32808	5.400184	68.63032
Probability	0.001903	0	0.067199	0
Sum	28	97	1112.98	1.73E+08
Sum Sq. Dev.	17.40541	143.8514	15949.89	7.25E+14
Observations	74	74	74	74

4.2 Coefficient Correlations Analysis

The coefficient correlation is a tool to check the relationship among the two variables. If the correlation is> or equal to 0.5 then the positive and significant relationship among the variable. If the correlation is below the level of 0.5 then it is insignificant. Moreover if the correlation is > or equal to -0.5 then its show the negative insignificant relationship among the variables. The correlation lies between the -1+1.

Table No2 shows correlation matrix that used to calculate the direction of the variables either positive or negative and results indicated that a positive but not perfectly positive correlation BD with TQ is 0.175535, BI with ROA is 0.060172 and ROA with TQ is 0.457097.On the other side a negative but not perfectly negative correlation BD with BI and ROA, -0.31382 and -0.00402 respectively, BI with TQ is -0.26943.

Table 2: Matrix Correlation

	BD	BI	ROA	TQ
BD	1			
BI	-0.31382	1		
ROA	-0.00402	0.060172	1	
TQ	0.175535	-0.26943	0.457097	1

4.3 Regression Results

Table no 3 and table no 4 display the results of regression technique for ROA and TOBIN'S Q. First column scrutinize the co efficient and second column shows the T-statistics. R-square display that how much proportion change will appear in dependent variable by change in 1 percent in independent variable. It appears that how much dependent variable is explained by independent variables. The result shows by given data is a significant and positive relationship between ROA and all other variables except BI that having a positive but insignificant relationship with ROA. R square, Adjusted R- Square, S.E. of regression and Durbin-Watson stat are -0.28126, -0.29905, 16.84735 and 0.407739 respectively. The same results of Ammar (2013).

Table 3: (ROA) Regression Results

Variable	Coefficient	t-Statistic
BD	11.33352	3.454701
BI	4.841499	4.591252
Regression statistics		
R- Square		-0.28126
Adjusted R- Square		-0.29905
S.E. of regression		16.84735
Durbin-Watson stat		0.407739

Table 4: (TOBIN'S Q) Regression Results

Variable	Coefficient	t-Statistic
BD	2816071	4.216192
BI	296192.2	1.379609
Regression statistics		
R- Square		-0.16872
Adjusted R- Square		-0.18495
S.E. of regression		3430050
Durbin-Watson stat		0.089266

5. CONCLUSION

The final conclusion of dependent variable (firms performance which have further two component return on assets and Tobin's q) and independent variable (board composition which have further two component one is dependant board as well as independent board) are indicates that is a significant and positive relationship between return on assets and other variable except board independent that having a positive but insignificant relationship with ROA. moreover board dependent show a negative but weak relationship between return on assets and board independent because the results shows a negative and less than 0.5.And positive but weak relationship lies among board independent and Tobin's q ,board independent and return on assets and Tobin's q with return on assets respectively.

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