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The Impact of Director Board's Characteristics on Firm Value: A Study on HOSE

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Abstract: ***The study was conducted to estimate the impact of director board's characteristics on the firm's value. In which, Tobin's q presents for the firm's value, and board's characteristics variables are dual role of CEO, numbers of female members, numbers of independent members, and CEO's ownership. The data was collected from the financial statements and annual reports of 101 non-financial companies listed on Ho Chi Minh Securities Exchanges (HOSE) during the period from 2008 to 2011. The data was processed by using STATA software with GLS regression technique. The regression results showed that CEO's ownership is the most important factor that impacts on the firm's value. The second important factor impacting the firm's value is numbers of independent member. Among the characteristics of director's board, CEO's ownership, the independent and size of the board of directors positively affect the firm's value; while the dual role of chairman has negative effect to firm's value. In addition, two other variables (ROA and Leverage) also affect positively to the firm value.***

Keywords: Director Board's Characteristics, CEO Ownership, Tobin's q, HOSE

1. Introduction

Firm's value is one of the most important resources of the business; it not only helps enterprises in building reputation, attracting capital but also in contributing to a nation's strong economy and sustainable development. Moreover, as firms are listed on the stock market, the firm's value has been significantly concerned. According to Shleifer and Vishny (1997), corporate governance deals with the ways in which suppliers that finance to corporations assure themselves of getting returns on their investment as expected and board of directors plays the role as a bridge between shareholders and managers. According to Saflieddine (2009), effective governance mechanism requires the active participation of all stakeholders, including the board of directors in supporting the continuous improvement of firm value. The lack of strong corporate governance could jeopardize the efficiency and internal controls of the organization because all business functions are correlated with each other. In this situation, the topic "The impact of director board's characteristics on firm's value – a study on HOSE" was chosen to study the relationship between characteristics of board directors and firm value with a quantitative approach. The purpose of this paper is to study how the characteristics of director board (gender, ownership of CEO, dual role, number of independent members and the size of the director board) impact on firm's value (Tobin's q). Data was collected from companies listed on Ho Chi Minh Securities Exchange (HOSE) for the period of 2008-2011.

2. Literature Review and Hypothesis Development

According to Aguilera (2005), the Board of Directors on behalf of shareholders oversees the management team, and serves as a bridge between shareholders and management team. The members of the board must comply with two basic principles: good faith and representative of the greatest benefit of company's shareholders. Ragothaman and Gollakota (2009) stated that in order to evaluate the board, the following characteristics should be considered: board size, the independence of the board and leadership structure. Therefore, the paper examined how the characteristics of director board influences on firm's value. Specially, hypotheses were proposed to test the relationship between the characteristics of the board, including board size, the percentage of female board members, CEO's dual role, the proportion of independent board members, and ownership structure and firm value.

- **Size of director board and firm value:**

In the relationship between director board size and the efficiency of business operations, there are two distinct schools of thought. The first school argues that smaller board size will highly contribute to the success of a business (Lipton & Lorsch, 1992; Jensen, 1993; Yernnack, 1996). They argue that as the board size increases, the conflicts of interest increase is accompanied by the appearance of obstacles in the process of communicating with each other, but which ultimately reduces the effectiveness and business value. In addition, the small board can react quickly to events. However, the second school argues that large-scale assemblies will improve business efficiency and business value (Pfeffer, 1972; Klein, 1998; Coles et al., 2008). The present studies show that large size of board will support and advise on the management of the enterprise more efficient because the business environment and corporate governance are highly complex (Klein, 1998). In addition, large size of board will gather more information. Coles et al. (2008) found evidence that large companies with diversified businesses and the business sector depending heavily on debt funding sources will obtain greater value from large board. With the presence of large-scale assemblies, the control and management will be emphasized rational and help improve the financial performance and financial costs of the business. So, the first hypothesis was proposed is that as follow:

H1: The size of director board impacts significantly on firm value.

- **Number of female members and firm's value:**

Number of female members reflects the diversity of the board (Dutta& Bose, 2006). There are three different reasons for recognizing the importance of the female members in the director board. First, the female members often have a better understanding about market rather than male members. Accordingly, this understanding enhances the board's decision. Secondly, the female members will bring better corporate image in the community and this contributes positively to the value of the business. Third, the other members of the board will improve the understanding of the business environment while the female members have a positive impact on the career development of female staff. As a result, the firm's value could improve directly or indirectly through the presence of the female members of the board. So the second hypothesis was proposed as follow:

H2: Number of female members in the board impact positively and significantly on firm value.

- **Dual Role of CEO and firm value:**

Shareholders interested in leadership structure of the board. Leadership structure concurrently will increase conflicts of interests between executives and shareholders because this leadership structure will cause the collusion between director board and management board (Fama and Jensen 1983). However, previous researchers found that the separation of roles between the CEO and chairman may not actually increase the efficiency of business operations. In addition, this separation will cause internal coordination problems (Faleye, 2007; Schmid and Zimmermann, 2008). The separation of roles is to ensure the balance of power between two appointed positions as well as to avoid conflicts of interest. If there is no separation between the management and control decisions, the board will not be able to effectively monitor and evaluate the true ability of CEO (Mary, 2005). CEOs tend to use their power in the role of chairman for the selection of directors who are obedient and have a willingness to serve them. In addition, a director board controlled by the CEO seems to lead to clear agency problems and make performance becomes worse. Thus, the CEO concurrently may lead to more conflict and reduce the effectiveness of business operations. Although empirical studies cannot provide a unified view of the contribution of dual role CEO on corporate performance, but there is a consensus among the shareholders, investors and the legislators that the board president should not also play the CEO role. Dahya et al., (2009) recommended that chairman of the board should not concurrently CEO. In Europe, 84% of businesses separate roles of chairman and CEO (Heidrick& Struggles, 2009). According to Hewa-Wellalage & Locke (2011), the rules of practice in Sri Lanka on corporate governance emphasize that the balance of power in the business will minimize any impact on individual decision-making influence. These rules recommend whenever dual role CEO of a business exists, the number of independent members should be larger to create a balance board to helps operate more efficiently. Realizing the importance of the separation of role between the chairman and CEO, during the period 1994 - 2003, many businesses have changed their dual role structure to non-dual role structure (Chen, Lin & Yi, 2008). The authors commented that in many businesses having dual role structure is having the abuse of power on the cost of the company and the shareholders. In Vietnam, the Ministry of Finance (2012) states that the board president should not hold both positions which are the company's CEO and chairman concurrently unless this is approved by the shareholders' general meeting every year. In addition, Fama & Jensen (1983) concluded that the dual role will reduce the supervision of the board leading to an increase in agency costs. So, the third hypothesis was proposed as follow:

H3: The dual role of CEO has a negative impact on firm value.

- **The present of independent member in director board and firm value:**

The independence of the board will determine the quality of the board and the independent directors can reduce the influence of the inner members (Clarke, 2007). The higher independent board is the more operational efficiency of enterprises will increase because independent members of the board will put pressure on the executive member (Rosentein et al., 1990). Many empirical studies recognized the importance of independent members to the success of a company. Elloumi and Gueyie (2001) concluded that the enterprises with highly proportion of independent members facing financial pressures less often. In addition, according to Daily et al., (2003), as the business environment getting worse, many enterprises with independent members would have a low probability of bankruptcy. Fama and Jensen (1983) explained that the independent board members can increase corporate value by using the experience and management of self-monitoring during the operation and be considered as protectors of interests of shareholders through the monitoring and inspection. Beasley (1996) explained the independent members have the good judgment and fair representation of shareholder interests, serve as a monitoring mechanism fully reliable and able to focus on ensuring protection of shareholder maximizing interest. Thus, the independence of the board guarantee for the higher firm value. However, other studies indicated that the independent members may also have a negative impact on firm performance because the members are independent decision makers do not have enough understand about current company's environment and company's status (Bhagat and Black, 2002, Fernandes, 2005; Mura, 2006). So, the fourth hypothesis was proposed as follow:

H4: The present of independent members in directors' board has a significant impact on firm value.

- **Ownership of CEO and firm's value:**

Brickley et al. (1988) concluded that ownership of CEO as an incentive for CEO, and this incentive will help CEO make the monitoring more effectively. Agreed with this view, Jensen & Murphy (1990), Chung & Pruitt (1996) assumed that the CEO's ownership will improve business efficiency. Mehran (1995) provided evidence of the existence of the relationship between CEO ownership and corporate performance. Morck, Shleifer and Vishny (1988) found that increasing the enterprise's value represented by the increasing of ownership holding by CEO. So, as the board members hold more shares in their company, it will be less conflict of interest and management members tend to administer business activities more appropriately. So, as if CEO holds shares, the performance of the business will be improved and ultimately increase company value. So, the fifth hypothesis was proposed as follow:

H5: Ownership of CEO has a significant positive impact on firm value.

3. Research model and variables' measurement

Tobin's qi,t = α + β_1 ROAi,t + β_2 Duali,t + β_3 Boardsizei,t + β_4 Independenti,t + β_5 Own_Ceoi,t + β_6 Femalei,t + β_7 Leveragei,t + Ɛi,t

3.1 Dependent variable

Topin's q represents for the firm value measured by the formula: ((the year end closing share price × number of ordinary shares outstanding) + Total liability) / Total Asset.

3.2 Independent variables

- ROA represents for the ability of generate profit by using the asset of the firm measured by the formula: Earning before tax / total asset. Earning before tax was used to avoid the bias could arise due to tax subsidiary policies applied for privatized firms, and new investment projects.
- Dual variable represents for the dual role of the chair of director board and the CEO of the company. It is the dummy variable equal to 1 if companies have the duality and otherwise equal to 0.
- Board size variable represents for the number of members of the board of directors. According to Vietnamese Enterprise Law (2005) the number of members of the board of directors is an odd number with the minimum number is 3 and the maximum number is 11. In this study, the board size of 3 or 5 was considered as small size which set 0, otherwise set 1.
- Independent is a variable which represents for the present of independent members in the board of directors. This is the dummy variable which equal to 1 if the board of directors has the independent member, otherwise equal to 0.
- Own CEO represents for the proportion of equity capital owned by the CEO of company.
- Female variable represents for the number of female members of the board of directors. It is a dummy variable which set 1 if company's director board has female member and set 0, otherwise.
- Leverage: represent of the financial leverage of the company which is measured by the formula: Total liability / total asset.

4. Data Collection and Processing

Data used to study is panel data set which was collected from the financial statements of firms listed on Ho Chi Minh City Security Exchange (HOSE) from 2008 to 2011. Multicollinearity, autocorrelation, heteroskedasticity phenomenon were tested by the correlation matrix and/or by VIF, "XTSERIAL" and "IMTEST, WHITE", respectively. And then, the best model regression was chosen. The tests resulted as the following:

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. vif

    Variable |       VIF       1/VIF
-------------+----------------------
         roa |      1.90    0.527482
     indepen |      1.69    0.589990
    levarage |      1.21    0.825206
      female |      1.12    0.896441
   boardsize |      1.10    0.910553
     own_ceo |      1.08    0.924184
        dual |      1.05    0.951139
-------------+----------------------
    Mean VIF |      1.31

. xtreg tobinsq roa dual boardsize indepen own_ceo female levarage, fe

Fixed-effects (within) regression               Number of obs      =       404
Group variable: company                         Number of groups   =       101

R-sq:  within  = 0.0389                         Obs per group: min =         4
       between = 0.0501                                        avg =       4.0
       overall = 0.0381                                        max =         4

                                                F(7,296)           =      1.71
corr(u_i, Xb)  = -0.4250                        Prob > F           =    0.1055

------------------------------------------------------------------------------
     tobinsq |      Coef.   Std. Err.      t    P>|t|     [95% Conf. Interval]
-------------+----------------------------------------------------------------
         roa |   .5328596   .2741829     1.94   0.053    -.0067352    1.072454
        dual |  -.0884536   .0597435    -1.48   0.140    -.2060294    .0291221
   boardsize |  -.1355804   .2480772    -0.55   0.585     -.623799    .3526382
     indepen |   .2150988   .1354224     1.59   0.113    -.0514139    .4816116
     own_ceo |   .6108522   .9174735     0.67   0.506    -1.194745     2.41645
      female |  -.0268765   .0378425    -0.71   0.478     -.101351     .047598
    levarage |  -.0096247   .0262039    -0.37   0.714    -.0611942    .0419448
       _cons |   .8597552   .1111799     7.73   0.000     .6409518    1.078558
-------------+----------------------------------------------------------------
     sigma_u |  .23452447
     sigma_e |  .21272891
         rho |  .54861656   (fraction of variance due to u_i)
------------------------------------------------------------------------------
F test that all u_i=0:     F(100, 296) =     3.11            Prob > F = 0.0000

. xtreg tobinsq roa dual boardsize indepen own_ceo female levarage, re

Random-effects GLS regression                   Number of obs      =       404
Group variable: company                         Number of groups   =       101

R-sq:  within  = 0.0221                         Obs per group: min =         4
       between = 0.2626                                        avg =       4.0
       overall = 0.1537                                        max =         4

Random effects u_i ~ Gaussian                   Wald chi2(7)       =     37.79
corr(u_i, X)       = 0 (assumed)                Prob > chi2        =    0.0000

------------------------------------------------------------------------------
     tobinsq |      Coef.   Std. Err.      z    P>|z|     [95% Conf. Interval]
-------------+----------------------------------------------------------------
         roa |    .848239   .2313281     3.67   0.000     .3948444    1.301634
        dual |  -.0381323   .0342937    -1.11   0.266    -.1053467    .0290821
   boardsize |   .0342927   .0403065     0.85   0.395    -.0447066     .113292
     indepen |   .0983061   .0528188     1.86   0.063    -.0052169    .2018291
     own_ceo |   .6718043   .3551077     1.89   0.059    -.0241941    1.367803
      female |  -.0208384    .030048    -0.69   0.488    -.0797314    .0380546
    levarage |   .0478648   .0139921     3.42   0.001     .0204407    .0752888
       _cons |   .6996689   .0412775    16.95   0.000     .6187664    .7805714
-------------+----------------------------------------------------------------
     sigma_u |  .15489067
     sigma_e |  .21272891
         rho |  .34646863   (fraction of variance due to u_i)
------------------------------------------------------------------------------
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5. Research Findings

The regression for OLS tool, REM and FEM give bad results and unreliable caused by model study has heteroskedasticity phenomenon. Thus, GLS regression was used to fix the problem.

Research result showed that dual role, the present of independent members, CEO's ownership and board size impact positively significantly on the listed firm's market value; while the dual role of CEO and chairman has a negative effect to the firm's value. In addition, ROA and leverage also affect positively significantly to the firm value.

Table 1: Summary of Regression Results

Variable (P-value)	Regression results			
	Pooling (OLS)	RAM	FEM	GLS
ROA	1.182077 (0.000)	0.848239 (0.000)	0.5328596 (0.053)	0.6265737 (0.000)
Dual	-0.03304 (0.227)	-0.0381323 (0.266)	-0.0884536 (0.140)	-0.035819 (0.009)
Board size	0.0412408 (0.153)	0.0342927 (0.395)	-0.1355804 (0.585)	0.0364239 (0.009)
Independent	0.0626375 (0.141)	0.0983061 (0.063)	0.2150988 (0.113)	0.0971821 (0.006)
Own_CEO	0.6805359 (0.010)	0.6718043 (0.059)	0.6108522 (0.506)	0.6782001 (0.000)
Female	-0.0189545 (0.494)	-0.0208384 (0.488)	-0.0268765 (0.478)	-0.0089675 (0.511)
Leverage	0.0626875 (0.000)	0.0478648 (0.001)	-0.0096247 (0.714)	0.0534793 (0.000)
_Cons	(0.6545043) (0.000)	0.6996689 (0.000)	0.8597552 (0.000)	0.6920 (0.000)

6. Conclusion

The research provided the evidence of the influence of the characteristics of the director board on firm value in Vietnamese context. The findings suggest that investors should consider the characteristics of director board of company as make investment decision in HOSE.

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