

Board Structure and Corporate Financial Performance in Vietnamese Listed Firms

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Abstract: *This study aims to demonstrate the relationship between board features and performance of firms listed on the Ho Chi Minh City stock exchange. There are six characteristics of board being considered, including board size, independent directors, chairman CEO, busy directors, foreign members on board, and managerial ownership feature. The data is collected from financial statements and reports of 194 firms classified to 9 industries. Both return on asset and return on equity are used to measure corporate performance. The results show the significant positive correlations between board size, foreign members and firm performance. In contrast, CEO duality has significant negative impact on ROA while significant positive effect is discovered when using ROE as performance measurement. This paper could not find significant relationship between independent members on board, busy directors and managerial ownership on firm performance. The findings may be suggestion to build corporate governance principles in Viet Nam and research in the future.*

Keywords: Agency cost, Board structure, Firm performance, ROA, ROE, Viet Nam

1. Introduction

Corporate governance has played an important role in a company and has a number of impacts on the firm's strategies, firm's operation as well as firm's performance. Researches of Klapper and Love(2002); Daily, Dalton and Cannella(2003); Leblanc and Gillies(2003); Bai *et al.*(2004); Durnev and Kim (2005); Black, Jang and Kim(2006) found out evidences that better corporate governance leads to better performance, in which many researches have done for emerging markets. In Viet Nam, nowadays, corporate governance has attracted more attention and firms have begun to care about corporate governance improvement via establishing and applying rules and regulations.

In corporate governance, one important mechanism, that many authors have done researches on, is board of directors. Some problems have been mentioned by related studies are the optimal board composition, characteristics of board and the effects of boards' features on firms' performance. While there are many authors analyze the effect of board on firm performance, the relationship between firm performance and boards of directors is still debated. This paper examines impacts of directors' board on performance of firms which are listed on the Ho Chi Minh stock exchanges and provides empirical evidence of director boards' effect on firm's financial performance. It not only contributes to the ongoing literature, but also gives some suggestions to complete the corporate governance principles of Vietnam. Board size, chairman CEO, independent directors, busy directors, foreign members on board, and managerial ownership feature are factors that this paper concerns. Return on asset and return on equity are used to measure firm financial performance. The results show that there is significant positive impact of board size and foreign directors on firm performance. While chairman CEO affects to firm performance positively when using ROE as measure, this relation is negative when ROA is used. Moreover, the results point out the insignificant association between independent members on boards, "busy directors", managerial ownership and firm performance.

The following section reviews the prior literature on the effects of board of directors to firms' performance. Section three describes data sources and methodology. Next section explains the empirical findings. Finally, the conclusions of this research have been summarized.

2. Literature Review

Agency cost

A joint stock company operates with the final goal that is maximizing shareholders' wealth. Managers who are hired to control daily activities of firms usually have different aims from shareholders like power, reputation, higher salaries or higher incomes. It could lead to conflicts between managers and shareholders. Some decisions of managers could be for their purposes instead of increasing shareholder wealth. Furthermore, managers tend to swap activities that bring long-term shareholders' interests for actions to pursue their own goals at the expense of the shareholders (Jensen and Meckling, 1976; Evans and Weir, 1995). As a result, agency cost has become one of the most important factors that scholars pay more attention when doing researches on firm's performance.

The number of directors on board (board size)

The effects of board size to firm's performance are shown in past researches with different results. On the one hand, many researchers suggest the negative relationship between board size and firms' performance. Specifically, Guest (2009) studied a large sample of 2746 UK listed firms over period 1981-2002 to analyze impacts of board size on firms' performance and found out the negative relation. Many researches in US pointed out the similar results such as studies of Yermack (1996), Cheng, Evans and Nagarajan (2008), Coles, Daniel and Naveen (2008). It is explained that the cost of adding more members on board could outweigh the benefits due to conflicts and difficult decision-making among larger group (Lipton and Lorsch, 1992; Jensen, 1993; Yermack, 1996). In details, increased number of directors could result in problems of communication and coordination, decrease the ability of boards to control management (Jensen, 1993; Yermack, 1996). Jensen also

suggested that as board size grows up, CEO could have more power to control and make decision without strong dismissal.

However, the correlation of board size and firms' performance may be not strictly linear. This argument is demonstrated in research of Yermack (1996) by using samples of large US industrial firm taken in period 1984-1991. This paper suggested that a board including 4 to 10 members makes investors' evaluation about firms and profitability ratios decrease steadily while a bigger board (form 10 members) makes the firms' profit decrease less rapidly. In other words, only small and medium firms could suffer this problem.

On the other hand, some researches show positive association between board size and firms' performance (Abidin, Kamal and Jusoff, 2009; Shukeri, Shin and Shaari, 2012). Abidin et al (2009) did research on 75 listed companies on Bursa Malaysia and explain the different results compared to other past researches by differences in culture and nature of the firms. Big size board could enhance firm performance because it is difficult for anyone to control other members in a larger board and more directors could lead to easier to raise funds or exploit expertise and experience in running the business (Shukeri, Shin and Shaari, 2012). Board size is supposed to have positive impact on performance of larger firms, diversified firms, and firms that use more debt (Coles, Daniel and Naveen, 2008).

Independent directors

Board independence requires that family members, suppliers, or customers are independent and the Chair and CEO are different.

Board independence is measured by the percentage of outside directors who have no current potential business ties with the firm or no affiliation with the firm excepting for their directorship, for example current and past employees, customers, suppliers or relatives of managers (Choi, Park and Yoo, 2007).

Outside directors are supposed to influence firms' performance positively in some past researches (Baysinger *et al.*, 1985; Dehaene, De Vuyst and Ooghe, 2001). The appearance of independent non-executive directors on the board could limit agency cost (Fama and Jensen, 1983). Some countries understand the important role of external directors and set rules on number of outside members on board. For example, according to Malaysian code on corporate governance (2000), the minimum amount of independent directors on board should be one third to ensure making better decisions. Independent non-executive directors help to restrict activities that bring benefits to managers instead of shareholders, leading to the decrease in agency cost. The second sample is in Korea where government required in listed firms at least 25% of the board to be composed of outside directors after Asian financial crisis (Choi, Park and Yoo, 2007). These authors suggest that the effect of external board members depends on board composition as well as the features of the market in which the firm operates. Particularly, in an emerging market where

could suffer external shocks, lack liquidity and effective institutions, the insider-dominant boards could improve the efficiency through adding outsiders, especially foreign investors. This result differs from researches in US firms, where the market is liquid, stable and well-developed. It means the effect of outsiders on firm performance depends on the nature of market conditions in which the firm operates.

In contrast, some researches demonstrated that firms with high rate of independent members on board may perform worse (Shukeri, Shin and Shaari, 2012; Klein, 1998). The reason is stated that independent outside directors may lack not only the knowledge about the operation of firm, but also the understanding of corporate strategies (Klein, 1998).

Besides, other researches could not find any correlation of outside board members and firms' performance, like studies of Hermalin and Weisbach (1991); Mehran (1995); Klein (1998); Bhagat and Black (2000); Hermalin and Weisbach (2003).

Chairman also is CEO

Researches of Fosberg et al. (1999), Dehaene et al. (2001) found evidences that firms with dual leadership structure have higher performances which are reflected via operating income to total assets ratio and return on assets ratio. They argued that the chairman, when acts as the CEO, will try to improve corporate performance because it enhances his personal profile. In addition, in case of identical roles of managers and chairman, it is difficult to evaluate managers' performance exactly and independently. In fact, according to The Malaysian Code on Corporate Governance of 2000, board of directors should include the present of executive directors and non-executive directors to ensure the decision of the board is not dominated by a certain party. In addition, the chairman and the chief operating officer should not be the same person in order to balance power and authority (Abidin, Kamal and Jusoff, 2009).

However, others found out that there is not any difference between returns of firms that has dual CEO and returns of firms that has separated CEO and chairman, for example, study of Rechner and Dalton (1989) using data of companies from the Fortune 500 group from 1978 to 1983, and study of Shukeri et al (2012) researching on Malaysian public listed companies.

The number of directors also works outside (other companies)

"Busy directors" are supposed to affect firm's performance in both sides. On the one hand, the positive impact on firms is explained that "busy directors" tend to be well connected and have good social and political relationship, resulting in high evaluation of investors (Di Pietra *et al.*, 2008). On the other hand, a study of Core, Holthausen, & Larcker (1999) demonstrates ineffectiveness of boards when there is a greater part of directors that sit in more board at the same time and directors who receive payments from the company in excess of their board pay (grey directors).

Foreign directors

Corporate governance globalization has been more popular all over the world. The integration trend could lead to an increase in the number of foreign investors in firms. Moreover, investors only want to invest their money to a firm which could be controlled well. Consequently, foreign board membership is required to monitor firm actively. The presence of at least one foreign outside director, coming with new model of corporate governance, may enhance firms' performance (Choi and Hasan, 2005; Choi, Park and Yoo, 2007). In addition, foreign members on board are also considered as outside directors who will not harm shareholders' benefit in order to gain profits for themselves (Stulz, 1999). Adding foreign members on board could widen the ability of cross listing for firm because these directors encourage the international orientation of the firm, attract foreign investors and enhance company transparency. As a result, it could improve firm value. However, research of Darmadi (2010) found no influence of foreign directors on firm performance.

Board of directors holding company's shares

Managerial ownership feature is measured by the proportion of number of shares holding by board of directors to the total shares in the company.

Some studies provide evidences of the positive association between the existence of shareholding managers who own company's shares and firm performance like Jensen and Meckling(1976); Mohd Ali, Mohd Salleh and Hassan(2008); Abidin, Kamal and Jusoff(2009). However, other researches supposed the high ownership percentage of managers may create power and opportunities for shareholding managers to make decisions that consolidate their benefits instead of other owners' interest (Abidin, Kamal and Jusoff, 2009).

Firm performance measures

When considering effects of board' characteristic on firm's performance, researchers have used different measures to determine corporate performance and also had different results. The most popular measures of firms' performance are some financial ratios like return on equity (ROE) (Shukeri.et.al. 2012), return on assets (ROA), market- to book ratio (Dehaene, De Vuyst and Ooghe, 2001; Chen *et al.*, 2005). Furthermore, there are some other measures, for example, the value added efficiency of the firm's resources such as market value added (MVA), cash flow growth, economic value added (EVA), earning per share (EPS) growth, dividend growth, sale growth, asset growth (Coles.et.al 2001; Ho and Williams, 2003; Nahar Abdullah, 2004; Abidin, Kamal and Jusoff, 2009).

It is concluded that the influence of each board's feature on firm performance is inconsistent based on the results of past researches. Consequently, it is necessary to continue to study this problem.

3. Data, Methodology and Hypotheses

3.1. Sample and data sources

In this research, to investigate the relationship between corporate governance and firms' financial efficiency, we

collect data from 351 firms listed in the Ho Chi Minh City Stock Exchange (HOSE) during 2010 to 2016 period. Then we remove companies which do not have enough financial statements and governance data. After adjusting outliers, the data sample contains 1358 variables from 194 companies. The data is collected from financial statements, annual statements whereas share prices are extracted from the HOSE's website. The data was classified into nine industries according to HOSE's standard (www.hsx.vn) as shown in Table 1.

Table 1: Listed firms on HOSE

Industry	Total Listed Firms	Percentage
Materials	38	19.59%
Real Estate	26	13.40%
Energy	7	3.61%
Utilities	11	5.67%
Consumer Goods	26	13.40%
HealthCare	8	4.12%
Industrials	62	31.96%
Information Technology	6	3.09%
Financials	10	5.15%
Total	194	100%

3.2. Methodology and Models

According to Gani et.al. (2006), accounting based measures tend to fewer objectives than market based measures because of a number of uncontrollable factors. We consider six characteristics of board of directors as core independent variables of corporate governance. They are (i) the number directors on board (BOARDSIZE); (ii) CEO duality (CEODual); (iii) independent board of directors (INDEBOD); (iv) directors on board working for another firm (BUSYNESS); (v) foreign members on board (FOREIGNBOD) and; (vi) the proportion of shareholding of board of directors (BOARDSHARE). We also use firm size (SIZE), financial leverage (LEV) and the number of year firm listed on stock exchange (YEAR) as control variables.

In this research, we use multiple regression analysis (MRA) to determine the association between dependent variables and explanatory variables. In addition, correlation analysis is also used to find whether or not multicollinearity exist among independent variables. This study follows and modifies the model of Mashayekhi and Bazaz (2008) and Shukeri et.al (2012). Therefore, the equations are:

$$ROA_{i,t} = \alpha_{1,0} + \beta_{1,1}BOARDSIZE_{i,t} + \beta_{1,2}CEODual_{i,t} + \beta_{1,3}INDEBOD_{i,t} + \beta_{1,4}BUSYNESS_{i,t} + \beta_{1,5}FOREIGNBOD_{i,t} + \beta_{1,6}BOARDSHARE_{i,t} + \beta_{1,7}SIZE_{i,t} + \beta_{1,8}LEV_{i,t} + \beta_{1,9}YEAR_{i,t} + \epsilon_i \quad (1)$$

$$ROE_{i,t} = \alpha_{2,0} + \beta_{2,1}BOARDSIZE_{i,t} + \beta_{2,2}CEODual_{i,t} + \beta_{2,3}INDEBOD_{i,t} + \beta_{2,4}BUSYNESS_{i,t} + \beta_{2,5}FOREIGNBOD_{i,t} + \beta_{2,6}BOARDSHARE_{i,t} + \beta_{2,7}SIZE_{i,t} + \beta_{2,8}LEV_{i,t} + \beta_{2,9}YEAR_{i,t} + \delta_i \quad (2)$$

Table 2: Summarize of variables

Variable	Code	Explanation
Return on Asset	ROA	Net income/ Total assets
Return on Equity	ROE	Net income before extraordinary items/ Total equity
Total directors on board	BOARDSIZE	Ln(Total board of directors)
Chairman and CEO is a person	CEOdual	Dummy variable. Equal 1 if CEO is also chairman of company. Otherwise, 0
The number of independent directors	INDEBOD	Total independent directors/ Total board of directors
The number of directors work for another firms	BUSYNESS	Total directors works outside/ Total board of directors
The number foreign directors	FOREIGNBOD	Total foreign directors/ Total board of directors
The proportion of shareholding of board of directors	BOARDSHARE	Total share proportion of board of directors
Firm size	SIZE	Log(Total assets)
Financial leverage	LEV	Total liabilities/ Total assets
The number of years firm listed on stock exchange	YEAR	From the year list on stock exchange to 2016

3.3. Hypotheses

In this paper, the relationship between each of the independent variables and firm's performance ratios is hypothesized as follows:

- H₁:** There is a positive relationship between the number of directors on board and firm's performance.
- H₂:** There is a negative relationship between CEO duality and firm's performance.
- H₃:** There is a positive relationship between the proportion of independent directors and firm's performance.
- H₄:** There is a negative relationship between the percentage of directors work outside and firm's performance.
- H₅:** There is a positive relationship between the rate of foreign directors on board and firm's performance.
- H₆:** There is a positive relationship between the directors' ownership and firm's performance.

4. Empirical Results

4.1. Descriptive statistics

Table 3 presents descriptive statistics about dependent, independent and control variables. The average ROA is

0.156, ROE is 0.251. In addition, the maximum size of director board is 11 persons while the minimum is 3, with nearly 6 people on board of directors on average. In 194 firms under the research, the number of variables that exist CEOdual (chairman is also CEO) is 435 (account for 32.03%). Furthermore, as can be seen from table 3, on board of directors, the maximum independent directors is 5, member of directors working for another firms and foreign directors is 9 and 7, respectively.

Listed firms on Vietnam stock exchange heavily rely on debt, with an average ratio of 50 percent, which implies that their default risk is high. In selected firms, the average listed year is 9 while the minimum is 6, maximum is 16 years.

Table 3: Descriptive analysis

Variable	Mean	Std. Dev.	Min	Max
Dependent Variables				
ROA	0.156	1.031	-0.646	14.108
ROE	0.251	0.298	-1.033	2.053
Independent Variables				
BOARDSIZE	5.818	1.356	3	11
CEOdual	0.320	0.467	0	1
INDEBOD	1.002	1.298	0	5
BUSYNESS	2.733	1.906	0	9
FOREIGNBOD	0.314	0.874	0	7
Control Variables				
BOARDSHARE	0.332	0.233	0.000	0.876
SIZE	27.978	1.330	25.517	34.545
LEV	0.500	0.214	0.006	0.971
YEAR	9.036	2.696	6	16

4.2. Correlation Analysis

Table 4 presents the Pearson's correlation for all variables in this research. It is clear that BOARDSIZE is positively and significantly correlated with both two performance variables (ROA and ROE). This implies that firms with larger board of directors would have better financial performance. CEOdual and BUSYNESS have negative and significant correlation with ROA, while they are positive but insignificant with ROE, indicating that firms perform weaker in case of CEO is also chairman, or there is member of board of director work for another company. In addition, the result also shows that FOREIGNBOD is also positive and highly correlation with ROA, implying that firms could take benefits from management style of foreign directors. As for the INDEBOD and BOARDSHARE, we find that they are not significant and correlated with ROA, ROE, reflecting that independent directors and the proportion of shareholding of board of directors do not influence to financial performance.

Table 4. Pearson Correlation

	YEAR	LEV	SIZE	BOARD SHARE	FOREIGN BOD	BUSYNESS	INDEBOD	CEOdual	BOARD SIZE	ROE	ROA
ROA	-0.0222	0.145*	-0.120*	-0.004	0.055*	-0.065*	-0.036	-0.066*	0.133*	0.043	1
ROE	0.024	-0.253*	0.041	-0.014	0.041	0.024	-0.024	0.021	0.086*	1	
BOARDSIZE	0.173*	-0.006	0.299*	-0.017	0.219*	0.024	-0.074*	-0.042	1		
CEOdual	0.0274	0.053*	-0.028	0.039	-0.056*	0.019	-0.001	1.000			
INDEBOD	0.035	-0.074*	-0.117*	0.003	-0.080*	0.108*	1.000				
BUSYNESS	0.175*	-0.053	0.099*	-0.041	0.073*	1					
FOREIGNBOD	0.044	-0.003	0.189*	-0.010	1						
BOARDSHARE	-0.0008	0.026	-0.004	1							
SIZE	0.070*	0.286*	1.000								
LEV	-0.161*	1									
YEAR	1										

Note: * indicates the significant level at 0.05

Regarding to control variables, firm size has negative and significant correlations with ROA, but it has positive correlation with ROE. Financial leverage is positive and significant associated with ROA while it is negative and significant correlations with ROE. In addition, table X also shows that the length of time that company's common stock has been listed in HOSE (YEAR variable) is not correlated with ROA, ROE.

4.3. Regression Results

Table 5 gives ordinary least squares (OLS) regression results for each of ROA, ROE on the independent and control variables. The result indicates that, these variables explains about 29.9 per cent and 36.5 per cent of the cross sectional variation in ROA and ROE, respectively.

Table 5: Regression results

	Model (1) ROA	Model (2) ROE
BOARDSIZE	0.943*** (0.138)	0.0815** (0.0401)
CEOdual	-0.162*** (0.0574)	0.0281* (0.0167)
INDEBOD	-0.121 (0.117)	-0.0353 (0.0340)
BUSYNESS	-0.114 (0.0882)	0.00435 (0.0257)
FOREIGNBOD	0.438** (0.204)	0.0190 (0.0595)
BOARDSHARE	-3.23e-06 (1.73e-05)	-1.16e-06 (5.02e-06)
SIZE	-0.196*** (0.0225)	0.0240*** (0.00656)
LEV	1.057*** (0.134)	-0.410*** (0.0389)
YEAR	0.00141 (0.0101)	-0.00456 (0.00293)
Constant	3.563*** (0.591)	-0.321* (0.172)
Observations	1,357	1,357
R-squared	0.299	0.365

Note: ***, ** and * indicate the significant level at the 0.01,

0.05 and 0.1, respectively

Table 5 shows that the number of directors is positive and significant with firm's financial performance (both ROA and ROE) at the 1% level. It implies that board size do influence to firm performance. The larger board of directors, the higher financial performance companies display in HOSE. Hence, hypothesis H₁ is accepted. This result is consistent with Abidin, Kamal and Jusoff (2009); Shukeri, Shin and Shaari (2012). More members on board of directors contribute more ideas and skills, support others to control firms.

In CEOdual variable, this is dummy variable, with 0 and 1 value. It is clear that CEOdual is negative and significant with ROA (at 1% level), but this is positive and significant with ROE (at 10% level). It is an interesting point to note that in the hypothesis assume above, we believe that CEOduals negative impact to both firm performance variables (ROA and ROE). Therefore, we are going to reject H₂. This finding is contradict with previous researches such as Abidin, Kamal and Jusoff (2009) and Shukeri et.al (2012).

The number of independent board of directors (INDEBOD) is insignificant with ROA and ROE, suggesting that there is no relationship between independent board of director and firm's financial performance. It is interesting to note that the coefficient is negative while the theoretical model assumes a positive relationship. Therefore, hypothesis H₃ is rejected. This is similar with other researches when they do not find out any correlation of outside board members and firms' value (Hermalin and Weisbach, 1991; Mehran, 1995; Klein, 1998; Bhagat and Black, 2000; Hermalin and Weisback, 2003)

As can be seen from the Table 5, the coefficient for BUSYNESS is insignificant even at the 10% level. The insignificant t-value for this variable implying that there is no different in companies which have board of director work for another companies and other do not. Thus, hypothesis H₄ is rejected. It can be conclude that there is no evidence to support the notion that there is a relationship between board of director work outside and firm's financial performance.

The results of regression analysis demonstrate that FOREIGNBOD has positively impact to financial performance. However it is significant with ROA at 5% level while insignificant with ROE at even 10% level. This is partly consistent with hypothesis H₅. Several studies have similar results like Choi and Hasan (2005); Choi, Park and Yoo (2007). We are going to rejected H₅, although there is statistic evidence that foreign board of director is positive influenced to firm performance.

The percentage ownership of board of directors (BOARDSHARE) shows the insignificant at 10% level with firm performance. However, the coefficient is negative, implying that when board of directors holds more shares of firms, this leads to lower financial performance result. This is contrary to the theoretical model and therefore, rejected H₆. The result is opposite with the finding of Jensen and Meckling (1976); Mohd Ali, Mohd Salleh and Hassan (2008); Abidin, Kamal and Jusoff (2009), they believe that when board of directors hold more shares, they would act to enhance shareholder's value.

Regarding to control variables, the regression analysis indicates that firm size and financial leverage is significant to financial performance at 1% level. To be more specific, firm size has negative impact on ROA (with coefficient value is -0.196) while it is positive with ROE. However, financial leverage has positive influence on ROA, and negative effect on ROE. In addition, it is clear from the table 5, there is no relationship between the number of years firm listed on stock market and firm's financial performance (the coefficient for YEAR is insignificant at the 10% level).

5. Conclusion

The purpose of this research is going to examine the relationship between board of director and firm's financial performance. The results show there are positive relationship between ROA and the number of board of director (at 1% level), foreign board of directors (at 5% level), and financial leverage (at 1%); and negative coefficient with chairman CEO of companies (at 1% level), firm size (at 1% level). In addition, board size, CEO dual and firm size are positive and significant with ROE, at 5%, 10% and 1% level, respectively. By contrast, financial leverage is negative and significant with ROE (at 1% level). The regression result also shows that there is insignificant relationship between independent board of directors, board of director working outsidess, the number of years that firm listed on stock market and financial performance.

The result implying that listed firms in Vietnam should keep the larger board size to take advantages of huge ideas as well as skills from them. Furthermore, it is important to have foreign board of director to improve financial performance because of their professional working style and knowledge. Regarding to overload working at the office, the results indicate that it is necessary to separate CEO and chairman position in Vietnamese listed firms because companies have one person keep both positions would have negative ROA at the 1% level compared to 10% level at ROE (with positive influence).

In evaluating the results of this research, several limitations should be considered. Firstly, the data is only collected from the Ho Chi Minh City Stock Exchange, while there is another stock exchange in Vietnam (the Hanoi Stock Exchange), therefore, the results may not be represented to the whole listed market. Secondly, our research collect data from 2010-2016, it does not include before and after the financial crisis period data (2007-2009). Consequently, this may not fully reflect the role of board of director in firms' financial performance results.

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