CORPORATE GOVERNANCE: THE THEORETICAL PERSPECTIVE OF BOARD LEADERSHIP STRUCTURE AND THE FIRM PERFORMANCE

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ABSTRACT

Corporate governance has been bounded by controversy due to the recent unfortunate events of unethical and irresponsible behavior by the managers as related to fraud and economic crises of international corporations. The purpose of this paper is to examine the theoretical and empirical literature on board leadership structure and the firm performance. The review willidentify the context in which corporate governance occurs as potential to international trends that focus on extensive body of knowledge on how CEO/Chair duality would influence the firm performance, and to figure out whether CEO/Chair duality has any certain impact on firm performance with reference to agency and stewardship theory, as there are mixed results produced by researchers. Finally, is of paramount important, if further theoretical studies are carried out to improve national and international standards concerning corporate governance with the aim of balancing the interests of organizations and their stakeholders.

Keywords: Corporate governance, Board leadership structure, Firm performance

INTRODUCTION

Corporate Governance has become an issue of international significance. Most of academicians and experts in the field argue that an independent board of directors is the main condition of effective firm

performance, CEO duality allows the CEO to serve as board chairperson, has become an important issue in the discussions of board independence. The factors that weaken corporate governance largely contribute to systemic failures, corporate scandals and failures resulting from fraud and other forms of malfeasance, this on the long run will affect negatively the performance of any company.Jaimes-Valdez, Jacobo-Hernandez,& Ochoa-Jimenez, (2017)as an experts have argued that the collapse of many big corporations is to a large degree traceable to weak corporate governance practice.

Corporate governance is a pivot or system of controls, processes, policies, rules and proceedings established by the Board and Management of a company to ensure the smooth running of the company, maximize shareholders wealth and satisfy the interest of every stakeholder. According to Owolabi& Dada, 2011 cited in Ademola, Moses, &Ucheagwu, (2016) defined Corporate Governance as the set of processes, customs, policies, laws and regulations affecting the way a corporation or company is directed, administered or controlled and according to Organization for Economic Co-operation and Development, OECD; (1999) cited in Yousuf, and Islam, (2015) 'comprehend corporate governance as a system by which business corporations are directed and controlled'. Similarly, Cadbury, (2000) cited in Nadarajan, et al, (2015) defined corporate governance as a system through which organisations "are directed and controlled".

The corporate governance would explain the theoretical concepts of board leadership structure and firm performance. A research was conducted among the board of directors of fortune 500 companies in which 95% are not doing what they are legally, morally, and ethically supposed to do. It is criticized that (1) the board

is a rubber stamp, (2) the board is dominated by CEO, and (3) the board is plagued with the conflicts of interests (Weidenbaum, 1986 cited in Rashid 2017);

Therefore, the main trust of this paper is to examine the theoretical and empirical literature on corporate governance (CEO/Chair duality) and to see whether there is a rapport between board leadership structure and firm performance. However, in these contexts the research will focus on extensive body of knowledge on how CEO/Chair duality would influence on firm performance, as there are mixed results produced by researchers. Some viewed international financial world is facing rapid changes in terms of financial as well as economic systems. These systems have been upsetting from years as a result of introduction of new technologies in both services and product industry around the globe has created issues to govern the global environment (Faisal & Abdul, 2015 cited in Ademola, Moses, &Ucheagwu. 2016). All these circumstances have forced the countries to adopt a sound system of corporate governance which enable them to survive in dynamic and open environment of innovations.

The Board Leadership Structure and the Firm Performance

The board leadership structure is predominant in United State (US) companies where they practice combine CEO/ Chair duality than European and Australian companies that have a split leadership structure, where the firm performance is being comprehended in board leadership structure be it public or private sector institutions.

The impact of separation of ownership and control on performance of firms has been the subject of debate in numerous studies. Board leadership structure has become an important subject.

According to Balagobei, &Udayakumara, (2017)assert that board leadership structure, top managerial officer of the corporation simultaneously serves as chairperson of the board which has the charter of monitoring and overseeing top management while, Akbar, (2015) 'pointed out that for effectiveness of board leadership structure in a business or company setting should consist of ownership concentration, board size, board composition, and dual role of CEO and Chairperson of board of directors'.

The board leadership structure could be board members, gatekeepers, shareholders and interested parties, such as professional associations where roles of board of directors and shareholders become the main focus area of corporate governance. Compositions of board basically move by insider directors that could be management who have enormous knowledge and information on corporation's activities.

On the other hand, the firm performance is an important concept that relates to the way and manner in which financial resources available to an organization are judiciously used to achieve the overall corporate objective of an organization, it keeps the organization in business and creates a greater prospect for future opportunities. Firm performance may also refer to the development of the share price, profitability or the present valuation of a company (Melvin and Hirt, 2005 cited Balagobei, &Udayakumara, 2017)

Coram, et al. (2006); and Chua, (2006) cited Ademola, Moses &Ucheagwu (2016)were of the opinion that sound corporate governance practices leads firms towards the achievement of higher performance; provide sources for capital investment by increasing the creditability of shareholders.

Role of Board Leadership Structure and Firm Performance

The role of Chairman of the Board of Directors and Chief Executive Officer as whether they should be separated or combine as the practice of one person at the same time being the firm's CEO and Chairman has been viewed as a double-edged sword' (Finkelstein, and D'Aveni, 1994 cited in Yu, and Ashton, 2015). The tasks played by board leadership structure is providing legitimacy, administering advice and counselling, acting as a link to important stakeholders or other significant bodies, facilitating access to resources such as capital, building external relations that may lead to the attainment of the firm performance and its objectives as well as profit maximization.

The factors that contributes towards board effectiveness to firm performance was reported by Carter and Lorsch (2003, p. 8) cited in Adawi, and Rwegasira, (2010) suggested that "structure, composition, and processes" which are the explicit design choices for every board to contain.

Therefore, the decisions of the board's must be aligned to the role it intends to play in the complexity of the company' and he further advocate that boards must go back to the basic of their roles in which various elements in its design should be taking into consideration:

1. The board structure: its size, leadership, and the committees it requires to accomplish its role
2. The board composition: the mix of experience, skills, and other attributes of its members
3. Board processes: how it gathers information, build knowledge and make decisions.

Board Size: Board size is the number of members of a board of directors, while board structure is the proportion of board members who were outsiders which serve as a critical determinant of a firm's performance to success that relay heavenly on the complexity of its governance structure. Cadbury report (1992) cited in Azeez, (2015) 'recognises the board of directors as an individual responsible for setting the company's strategic aims, providing the leadership that are put into effect, supervising the management of the business and reporting to shareholders on their stewardship.

In most of the studies, many are of the view that board size may affect firm performance directly and others are of the opinion complexity of firm's environment may reflect on the firm performance. According to Jensen (1993) cited in Azeez, (2015), 'argue that causes for board failures on the firm performance cannot be clearly understood, he identifies board culture, information problems, lack of management and board member equity as causes for board failures to firm performance'. He also points out oversized boards as major cause for board failures but, keeping small boards can help to improve firm performance and concludes that when board gets beyond seven or eight members they are less likely to function effectively and are easier for CEO to control. In the same vein Kajola (2008) cited in Yousuf, and Islam, (2015) 'recommended that board size should be within a limit of the firm's width of operation' but in research conducted by Lipton and Lorsch, (1992) cited in Vieito, (2013) 'argue that when the board size is large it helps in monitoring of the firms performing'. The arguments behind the two party is that large board would lead to higher amount of agency problems and would lead to ineffective management that may eventually lead poor performance of the company.

Contrary Haleblian and Finkelstein (1993) cited in Adawi, and Rwegasira, (2010) 'contend that larger boards contribute immensely to a greater firm performance, because they bring together specialists from various functional fields'. The main advantage of a large board is that a large group has more problem solving capabilities.

Bhagat and Black, (2000) Dalton, Daily, Ellstrand, and Johnson, (1998) Westphal, (2002) cited in Gabrielsson, Huse, and Minichilli, (2007), argue that most research conducted on boards and governance shows that constant changes in the board leadership structure do not yield any strong results, either in improving board effectiveness or firm performance

Tentative Model of Determinants of Board and Firm's Performance

A research conducted by Adawi, and Rwegasira, (2010), classify the factors that determine the board and firm performance into three general categories:

Section **'A'** involves the factors that can be grouped as board's characteristics that identify and design the board of directors in terms of the following

1. Board Structure: This comprises of board size, board committees, board leadership structure in form of chairman/CEO duality.
2. Board Composition: In this segment it may include the executive/non-executive directors, education of board members which take as weight board director's education level and experience of board members as to weight board director's age
3. Board Processes: This link brings the company information as in corporate communication and the announcement of board meetings

Section **'B'** this entails the factors that can be grouped as shareholders' characteristics, which include:

1. Ownership concentration/dispersion

2. Private institutional shareholders

Section **'C'** category represents the following:

1. Company size is represented by the annual sale
2. Industry
3. Financial Leverage

Contended Theoretical Perspective on Board Leadership Structure

The needs for board leader structure in corporate governance stems from the problem of agency issue that helps to resolved the potential conflicts of interest amongst the stakeholders that are shareholders, management, public administration, personnel dependent, and consumers, to mention but few in a company. Consequently, this structure mean to specify the rights and responsibilities between different members and contributors in the establishment such as, the board, managers, shareholders and other stakeholders as to the rules and procedures for taking decisions on matters concerning the wellbeing of the firms.

Many researches have been taken in this field of corporate governance are aimed to figure out whether CEO/Chair duality has any certain impact on firm performance and in aspect the agency theory, stewardship theory, as well as the empirical researches on CEO/chair duality will be discussed in turn. The Supporters of CEO/Chair duality based on stewardship theory claimed that holding both positions will improve the performance while opponents of CEO/Chair duality rely on agency theory to make their argument.

In understanding of **agency theory** in corporate governance, implies that adequate monitoring mechanisms need to be established to protect shareholders from management's self-interests with an anticipated that the separation of the chairman and CEO

roles leads to greater scrutiny of managerial behaviour that leads to better firms performance' (Lorsch and MacIver, 1989; Millstein, 1992 cited in Jackling, and John, 2009). Jensen and Meckling, (1976) Fama and Jensen, (1983) cited Nicholson, and Kiel, (2007) 'contend that the theory concentrate on links between board independence and board leadership structure of various arms that contribute to the effectiveness of the firm performance'. He further defines agency relationship and identifies agency costs as "a contract under which one or more persons (the principal(s) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent". Looking at this perspective of the theory, the interests of shareholders are only ensured when different people occupy the two positions of CEO and chairman of the Board. The burning issue for agency theory is the separation of the roles of CEO and Chairman and this non-duality allows the Board to symbolize the rights of the shareholders (Krause, Semadeni, and Cannella, 2014)

Contrary to agency theory, **stewardship theory** emphases on the proportion of insiders on the board to investigate links with firm's performance and the theory postulates that managers are essentially trustworthy individuals and so are good overseers of the resources entrusted to them (Donaldson, 1990; Donaldson and Davis, 1991 cited in Vieito, 2013), and the assumption of these theory stress that there is no conflicts of interest between managers and owners and that standpoints of board leadership structure is to find an organizational structure that allows coordination to be achieved more effectively to the firm performance (Donaldson, 1990).

The concept of board leadership structure (CEO/Chair duality) in practice, it supports stewardship theorists to

claim that the manager "protects and maximizes shareholders' wealth through firm performance, because, by so doing, the steward's utility functions are maximized" (Davis, 1997) cited in Nadarajan, et al, (2015). Further critics to the stewardship theory have argued that boards can become redundant when there is a dominant active shareholder, especially when the major shareholder is a family or government

The Theoretical Considerations of Agency and Stewardship Theories

From the above theories, the agent may be driven by self-interest due to the separation of ownership and control. The board composition in form of representation of outside independent directors will be able to provide important monitoring functions in an attempt to resolve the agency conflict between management and shareholders.

Similarly it can be argued that the outside independent will bring independent advice which stewardship theory ignores (Nicholson and Kiel, 2007 cited in Rashid. 2017). In the same vein, consistent with "agency theory", which observed that the CEO duality will reduce the firm performance. The "CEO duality diminishes the monitoring role of the board of directors over the executive manager, and this in turn may have a negative effect on corporate performance" (Elsayed, 2007, p 1204 cited in Rashid. 2017, p 6).
The board leadership structure (CEO/Chair duality) based on the supporters view of stewardship theory assert that managers are stewards whose behaviors are associated with their principles, loyalty to firm and attempts to achieve the maximum firm performance. On the other hand, challengers, rely more on agency theory to argue that the separation between these two is necessary to avoid the conflict of interest.

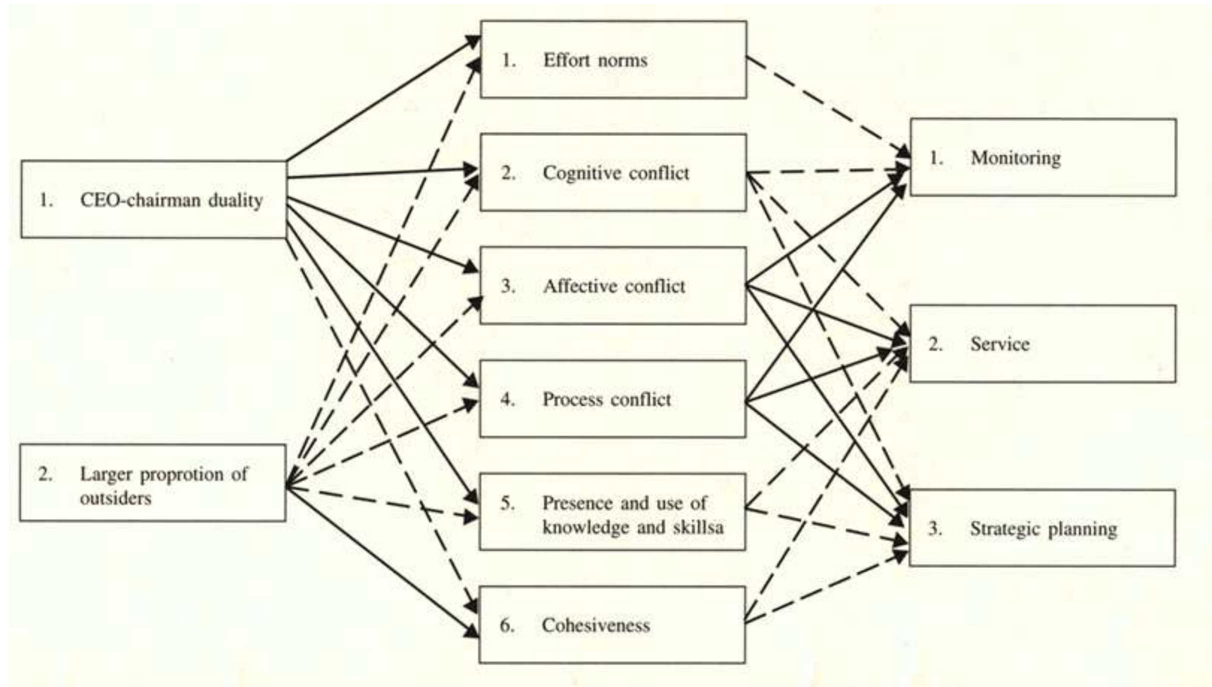
Therefore, up to now, the issue is still inconclusive; some researches show that there is no relationship between COE/Chair duality and firm performance but some strongly believed that there is positive relationship otherwise others claimed for a negative relationship. Based on these theories, mixed empirical conclusions have been recognized.

The Effect of CEO Duality on Firm Performance

This is a situation where by a person in an organisation or company executive holds both the position of chairman and CEO of the board at the same time. This can be best explaining using opposing theories in research carried out by White and Ingrassia, (1992) cited in Rashid, and Islam, (2011) states that there are two theories related to the role of leadership structure that affect the performance of a company;

1. Organisation theorist: Organisation theories suggest that duality brings about enhancement in firm performance by providing clear and unambiguous leadership to the CEO (Donaldson and Davis, 1991 cited in Kang and Zardkoohi, 2005) and in contrasts
2. Agency theorist: Agency theorists submit that duality decreases firm performance due to CEO entrenchment and a decline in board independence frozm corporate management as establish in the Cadbury Code of Best Practice (Cadbury Report, 1992 cited in Loizos 2001)recommended that “there should be a clearly accepted division of responsibilities at the head of the company, which will ensure a balance of power and authority, such that no individual has unfettered power of decision” and it further argue that CEO/Chair duality reduces the checking effectiveness of the board over management, and backings separation of the CEO/Chair roles.

Conceptual Model between Board Structure and Firm Performance



According to Nadarajan, et al, (2015), 'quoted Malaysian Code on Corporate Governance (MCCG) that said, never imposed segregation of CEO duality but, do inspire that the positions for CEO and chairman to be separated'.

In conflicting view point, Akbar, (2015) contend that proponents of the agency theory said that CEO Chair duality will weaken the control mechanism and negatively influence the role of board members in evaluating the activities of firm managers.

In addition Brown and Caylor (2006) cited in Akbar, (2015) suggests that effective performance of corporate governance structure cannot be adjudicated solely on the centre of the traditional measures of corporate governance such as the board size, board composition, CEO/Chair duality, but it should be more related to the firms policies and regulation

COE/Chair Duality Compensation

The compensation structure is the powerful incentive alignment mechanism to the firm's performance which should be associated with the board structure. Rediker and Seth (1995) cited in Yousuf, and Islam, (2015) argue that CEO long term compensation should substitute to some extent for the need vigilant and performance of the company board. This aspect is more related to the payment mix as the proportion of total remuneration paid in long-term form. For instance options in stock, bonus, pension, limited stock and long-term inducement plans are to be calculated as long-term reward divided by total compensation.

CONCLUSION

Conclusively, the reports discussed on board leadership structure (COE/Chair duality) as related to board sizes within the rules of corporate governance as well as the impact of board leadership structure and the firm's performance. The context bring forward some of the theories associated with corporate governance which stems from the problem of agency issue that helps to resolved the potential conflicts of interest on board leadership structure of CEO/Chair duality in the organisation among shareholders, management, public administration, personnel dependent, and consumers, to mention but few in one corporate structure. In extreme streams of board practices it has been observed that the board leadership structure or compositions in the form of representation of outside independent directors and structural independence of the board influence the firm performance.

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