DO BOARD COMMITTEES AFFECT CORPORATE FINANCIAL PERFORMANCE? EVIDENCE FROM LISTED COMPANIES IN GHANA

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ABSTRACT: *This research has examined the effect of board committees on corporate financial performance among companies listed on the Ghana Stock Exchange (GSE). The quantitative research approach was adopted to study the prognostic effect of board committee on corporate financial performance for companies consistently listed on the GSE from 2006-2010. Data was sourced from annual reports of listed companies and a static panel regression model was employed to analyze the presence of various committees on corporate financial performance. The results indicated that board committees had no statistical significant effect on the corporate financial performance of listed firms. Specifically, nomination committee regressed negatively on corporate financial performance but was statistically insignificant at the 5% level, with audit committee having no effect whiles remuneration committee predicted positively but also not statistically significant on corporate financial performance. The outcome suggests that the internal workings of corporate boards were weak implying that the effective supervision expected of these committees in terms of executive recruitment, succession planning, internal control, effective financial reporting, and the fixation of executive remuneration are lacking. The author recommends that board committees be strengthen with capable outside directors, skillful in the various technical areas to assist committees deliver on their responsibilities by instituting transparent selection processes. Listed firms must also desist from the selection of outside directors because they will sustain the dominance of the board to a more strategic selection approach where outside directors exercise unflinching oversight responsibility to enable firms reach their long-term goals.*

KEYWORDS: Corporate governance, board committees, corporate financial performance

INTRODUCTION

Worldwide corporate governance is perhaps synonymous with corporate boards who have statutory duties to represent and protect shareholder interest basically by formulating corporate strategy and instituting control mechanisms through the mix of skills and talents available to the board. Yet, board functional effectiveness to a large extent is connected to the inner workings of the board by various standing board committees which support and complement boards decision-making and supervisory functions. Indeed, the time available at board meetings make it difficult or almost impossible to ensure that the board gives in-depth consideration to all matter for which it is responsible (Chambers, 2002). Appropriately, it is more efficient for matters to be considered first by a specialized standing committee of the board rather than the full board which may not be meeting frequently or may not be effective in handling certain technical issues efficiently. It has been suggested that in order for the board to effectively exercise its strategic and oversight responsibilities, it is necessary to have critically composed board committees to support board's

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ability in executing these fundamental responsibilities (Bilimoria & Piderit, 1994). Kesner (1988) opines that since most decisions of the board are initiated at the committee level, board effectiveness is thus enhanced through the type and composition of board committees. In this regard, market regulators across the globe including the Securities and Exchange Commission (SEC) of Ghana recommends that listed firms as part of the internal corporate governance mechanisms have on their boards standing committees of audit, remuneration, and nomination to assist with the multiple functional responsibilities of the board.

Despite the theoretical popularity of board committees in various corporate governance literatures, few previous researches have credited board effectiveness with the composition and independence of board standing committees especially in supporting corporate financial performance and shareholder value maximization (Fernando, 2006; Bilimoria & Piderit, 1994). For example Fernando (2006) indicated that problems associated with information asymmetry which are likely to affect the quality of board decisions are largely resolved through the workings of independent board committees, with the right combination of skills and experience. Consistently, board committees have been endorsed with providing corporate boards with critical support across multiple technical functional areas of audit, quality financial reporting, and executive remuneration as well as succession planning (Jiraporn, Singh, & Lee 2009).

Again, prior studies concerning corporate board effectiveness are biased towards board composition variables of board size, CEO duality, and the proportion of inside to outside directors which are mostly inundated with inconsistent findings (Hutchinson, 2002; Caylor, 2006; Christensen et al. 2010). Moreover, board committee literatures in many instances have examined the effect of single board committees rather than the entire standing committees of the board (Newman & Mozes, 1999; Sun & Cahan, 2009) making it difficult to link board effectiveness to board standing committees. Against this backdrop, this paper provides an examination of how the presence of board standing committees (audit, remuneration, and nomination) has affected Corporate Financial Performance (CFP) among listed firms in Ghana.

2.0 Literature Review

A foundational structure for understanding corporate boards in firm operations and performance is dependent on understanding of the owner-board relationship through the agency theory. The agency theory is a concept which expresses a contractual relationship between two parties often referred to as the principal and agent (Shapiro, 2005). The theory provides a description of the modern corporation as a complex web of multiple relationships between capital holders (shareholders/principals) and their multiple principals, and executives (agents) and their multiple agents (Cardoso et al., 2007). Studies have shown that though the structure has provided means for attracting capital from dispersed owners to fund huge investments, the agency problem has never departed from the modern corporation. Guinnane et al., (2007) and Millon, (2007) have argued that despite perceived merits associated with the Joint Stock Limited Company, it is still considered as an innovative channel for mobilizing financial capital for funding huge investment. Similarly, Chang (2000) also asserted that the introduction of the limited liability eliminated fear associated with owing a sole proprietorship or/and partnership business because it insulate shareholders from the liabilities of the company since the enterprise is treated as legal person capable of handling its own liabilities, and can sue and be sued with perpetual existence.

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The agency problem begins with the separation of ownership and control (Berle and Means, 1932). The theory takes the view that in the situation where ownership has been separated from control, theoretically the agency theory assumes conflict of interest challenges because owners (shareholders) will perceive agents (executives) as maximizing personal utility at the expense of shareholders' due to the opportunistic state of affairs created through the separation. Additionally, information asymmetrical challenges where the agent is better informed about what is going on in the firm than the provider of capital may also arise. Perhaps what has still made the modern corporation that popular among ownership structures and corporate executives is the entity's ability to institute monitoring and incentivizing mechanisms aimed at controlling the agency problem. Monitoring and incentivizing mechanisms are initiated first to align the interest of agents (executives) to shareholders (principals), and second to induce corporate performance so that shareholders wealth is maximized (Denis, 2001).

Board Committee

Studies have shown that corporate boards are one of the main monitoring mechanisms used in solving the agency problem (Hermalin and Weisbach, 2001). Theoretically, corporate boards are elected by shareholders at annual general meeting and aside providing strategic direction to the company, they are expected to control executive management. Accomplishing the above functions creditably implies that boards must be seen to be independent and board mechanisms should lead to minimization of the agency cost associated with the agency problem (Abdullah, 2004). Both the alignment and the agency theories suggests that corporate boards must implement various mechanisms (board composition, board size, frequency of board meeting, board committee etc.) in order to align the interest of opportunistic agents (executives) to shareholders (principals) interest.

To effectively monitor executive management and perform other tasks involving serious agency problems, such as setting executive remuneration, engaging external auditors, and hiring and firing CEO, boards are often subdivided into smaller committees McClogan (2001). Typically, there are three main board committees that support the work of the board; this includes audit, remuneration, and nominations committee (Anand, 2007). Conceptually, these standing committees assist the board to perform its oversight responsibilities. The committees are composed of expertise board members who technically deal with specialized issues that the board as a whole will waste much time in handling. The agency theory suggests that due to the controlling nature of these committees, they must be independent and as such be composed of majority independent outside directors who do not have any contractual relationship like inside directors. The theory views majority independent outside director composition of board committees as a mechanism to solving the agency problem (Zubaidah, 2009).

Audit Committee

Audit committees have several opposing but sometimes complementary perspectives with regard to corporate governance (Beasley et al, 2009; Cohen, Krishnamoorthy, and Wright, 2002, 2007b; Kalbers and Fogarty, 1998). Given the nominal control that shareholders have over the corporation, the agency theory suggests that it is important that principals be granted sufficient and adequate information about the financial health of the company. The theory further opines that

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since management run the day-to-day affairs of the company and therefore are privy to sensitive financial information than other directors, ideally, there should be on the board a controlling decision body to serve as a check on executive management's activities in terms of financial and internal control issues with the sole aim of minimizing conflict of interest dilemmas associated with the separation of ownership and control (Fama and Jensen 1983; Jensen and Meckling 1976; Beasley et al., 2009).
Practically, in many jurisdictions the audit committee is composed of three independent members who share no contractual relationship with the firm and preferably a member be financially literate to assist in the analysis of the financial report presented by executive management to aid in asking pertinent questions in line with their supervisory responsibilities (Sarbanes-Oxley, 2002; Combine Code, 2009). Principal functions of the audit committee are in the areas of appointment of external auditors, review of the annual financial report and internal control issues (Mintz, 2008)

Remuneration Committee
Despite the use of incentive mechanisms in aligning the interest of agents to principals, the perception of CEO and top executives behaving opportunistically to maximize individual utility at the expense of shareholders still exist (Williamson et al., 1975; Conyon, 2006; Core et al., 2005). Compensation or remuneration committee is a sub-committee of the board of directors responsible for establishing and monitoring remuneration package and policies of inside (executive) directors and the board as a whole (Anderson and Bizjak, 2003; Conyon and He, 2004). The agency theory has advocated that executive remuneration be tied to shareholder value and be adequate enough to induce maximum performance (Jensen & Meckling, 1976; Jensen & Murphy, 1990). By this, executive remuneration is expected to be consistent with corporate performance and in conformity with shareholders' wealth. It is the responsibility of the remuneration committee to ensure the adoption and implementation of a remuneration policy which follow the alignment theory. Stelzer (2000) suggest that the responsibilities of the remuneration committee have recently increased due to media reports on excessive executive remuneration which in many instance does not seem to align with shareholders value.

Nomination Committee
The agency theory explains that to maintain the independence, accountability, transparency, objectivity and fairness of the board, it must ensure a proper mix of outside and inside directors. The nomination committee assist the board in discharging its responsibility of recommending and presenting new directors who have been appointed and old directors in the annual general meeting for approval and re-appointment. Again, the theory suggests that in order that the principal's interest is protected at all times, agents must show integrity, utmost faith, competency, duty of care, and loyalty free from conflict of interest and opportunism. This can be achieved when board appointment, recruitment, and selection process are transparent devoid of any executive management manipulations or influences by majority shareholders

The theory expects that the appointment and selection process of executive management be based on qualification, experience, skill, and for supervisory directors, independence and availability of the member be included. Annual review of the composition of board and succession planning of the CEO and other executive positions should be one of the important responsibilities of the nomination committee. The agency theory opines that the nomination committee be composed of

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majority independent outside directors with the right skill set and experience in strategic human resource planning in order that the board be provided with the multiplicity of the knowledge required to function well. Huse (2007) has suggested that in selecting directors to the nomination committee, the board must take into consideration how the candidate director cares about his or her reputation, since reputational concerns serve as trustworthy signals which the board can rely on. Directors' reputational concerns are as a result of past experiences which go a long way to influencing present and future actions and behaviours (Sundgren & Schneeweis, 1988).

Board Committees and Corporate Financial Performance

Empirical evidences supporting the idea that many important decisions of the board are made in board committees and that those decisions affect corporate financial performance are very few and in most cases concentrated in advanced economies with little evidence from developing countries. Newman and Mozes (1999) revealed that CEO remuneration was higher than corporate financial performance when remuneration committee was composed of majority inside directors. Additionally, Sun and Cahan (2009) exposed that CEO cash remuneration positively associated with accounting earnings for firms with independent remuneration committees than firms without. Consistently, Adams, Hermalin and Weisbach (2008) uncovered that the composition of the audit committee is linked to quality financial reporting whiles Goh (2009) asserted that audit committee play significant role in solving the material weakness of internal control under the Sarbanes-Oxley Act.

Additionally, Klein (1988) was of the view that the composition of the audit committee is significant in predicting corporate financial performance among the standard & poor 500 firms from 1992 to 1993. These committees operated independently from one another and they are accountable to the board (Rezaee, 2009). Despite the agency prescriptions on the resourcefulness of board committees, there are few evidences that suggest that independent composition of board committees are linked to firm performance (Klein, 1998; Carter et al, 2010) For instance (Klein, 1998) found that though there is modest direct evidences that suggest that composition of board committees are more important than the composition of the board in terms of financial performance, however when it comes to the inner workings of the board there are few significant evidences that suggest that board committees are linked to firm performance.

Research Design

The positivist research methodological approach was adopted to examine the effect of board committees on CFP. The study made use of a quantitative approach using a panel data spanning between 2006 and 2010 on all firms listed on the GSE over the study period. The panel data employed was subjected to vigorous tests to produce the right model to give robust results.

Model Specification and Data Analysis

The static panel model below was adopted to explain or elaborate on the effect of the three standing board committees on CFP as follows:

$$CFP_{it} = \alpha + \gamma_i \sum BC_{it} + \vartheta_i \sum X_{it} + \mu_{it}$$

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The CFP_{it} in the model represents the dependent variable and it was measured by two accounting performance indicators, Return on Assets (ROA) and Return on Equity (ROE). Conversely, the independent variables for the study were captured by the variable BC_{it} which was an index used for three standing board committees. The committees used for the study were standing committee recommended by the regulator. The committees were measured as dummies with 1 representing the existence of the committee and 0 otherwise. Consistently, X_{it} in the model is a set of explanatory variables which controls the effect of other corporate governance policies on CFP. These includes shareholder concentration (SC), board size (BS) and the frequency of board meetings (FBM). The α in the model is a constant while $\mu_{it} = \mu_i + v_{it}$where μ_i is the firm specific effects which denotes the unobservable individual effects and v_{it} is a random term. γ_i and γ_i denote the coefficients for the board committee variables and controlled variables respectively. The subscripts *i and t* signifies the cross-sectional and time-series dimensions respectively.

Secondary data was sourced from the population of all thirty-one (31) listed companies on the Ghana Stock Exchange (GSE) from 2006 to 2010. The data was extracted from firms that have been listed on the Ghana Stock Exchange as at 2006 and have been consistently listed over the study period. A static panel regression model was estimated to analyze the effect of the presence and composition of board committees on CFP. Panel data models are usually estimated using either fixed-effects or random effects models. The quandary of choosing the most appropriate model (fixed or random effect) was overcome by performing the Hausman test to find which of these models was most appropriate. Moreover, a correlation of the variables was undertaken to ascertain the strength of association so as to avoid the problem of multi-collinearity. In all, the study tested the effect of independent variables of audit, remuneration and nomination committees on the dependent variable, CFP measured by Return on Equity (ROE) and Return on Asset (ROA).

RESULTS AND DISCUSSIONS

A summary of the important statistical indicators of the variables used in the model have been examined in Table 1. The results shows that ROA has an average of 0.3 with a minimum of -0.358 and 0.784 while return on ROE has an average of 0.26. On the average, board size of the various firms was 9, with a minimum of five (5) and a maximum of eighteen (18) members respectively. Additionally, board committees have a minimum of zero when not in existence and 1 when in existence. Shareholder concentration has a mean of 18.14 with a maximum of 23.4 whiles frequency of board meeting has an average of four (4) board meetings, a minimum of two (2) and a maximum of twelve (12) meetings in a year.

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Table 1: Summary Statistics of Variables

Variable	*Obs*	*Mean*	*Std. Dev.*	*Min*	*Max*
roa	145	0.295207	0.215263	-0.35837	0.784
roe	145	0.263756	0.365513	-0.71245	0.894563
bs	145	8.524138	2.230106	5	18
ac	145	0.931035	0.254274	0	1
nc	145	0.151724	0.359997	0	1
rc	145	0.372414	0.485124	0	1
sc	145	18.14382	3.868434	7.5725	23.39
fbm	145	4.221429	1.550437	2	12

A correlation matrix was performed to establish the strength of association between the variables in order to avoid the problem of multi-collinearity. Table 2 below has displayed the correlation matrix.

Table 2: Correlation Matrix of Variables

	roa	*Roe*	*bs*	*ac*	*nc*	*rc*	*Sc*	*fbm*
roa	1							
roe	0.4481	1						
bs	0.1828	0.0113	1					
ac	0.0307	-0.0693	0.1547	1				
nc	-0.0456	-0.1337	0.4175	0.1065	1			
rc	-0.0253	-0.0725	0.3245	0.2067	0.3817	1		
sc	0.1601	0.1535	0.2434	-0.0352	-0.0201	-0.2131	1	
fbm	-0.0567	-0.0474	0.2295	0.0398	-0.0551	0.2791	0.1391	1

The results showed that there exist positive relationship between board size and CFP. A similar relationship exists between shareholder concentration and both measures of corporate financial performance. While audit committee exhibits a positive relationship with ROA, it is negatively related to ROE. Both remuneration and nomination committees have negative relationships with the two measures of profitability. The frequency of board meetings tend to be negatively related to CFP. There was no problem of multicollinearity since the correlation coefficients indicated by the matrix were within acceptable limit. A panel static model was therefore estimated to establish the effect of board committees on CFP shown in Table 3 below. Before then a hausman test was conducted which lead the choice of the random over the fixed effects model.

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Table 3: Board Committees and Financial Performance

	(1) ROA	(2) ROE
sc	0.0066	0.0148*
	(0.0050)	(0.0088)
fbm	-0.0200	-0.0251
	(0.0126)	(0.0223)
rc	0.0092	0.0379
	(0.0455)	(0.0802)
nc	-0.1037*	-0.1934*
	(0.0627)	(0.1105)
ac	0.0131	-0.0875
	(0.0706)	(0.1244)
bs	0.0252**	0.0113
	(0.0104)	(0.0183)
_cons	0.0561	0.1033
	(0.1190)	(0.2097)
N	140	140
Wald Chi-2	11.5771	7.5819
Prob		

Standard errors in parentheses
** $p < 0.05$, *** $p < 0.01$

The results from the random effect model above show that nomination committee (NC) regressed negatively on both performance indicators (ROA and ROE) but was statistically insignificant at the 5% level. The findings contradicts the suggestion of the agency theory that nomination committees with the right composition of outside directors can result in the selection of independent, skillful, knowledgeable, and experienced board members for better oversight and strategic responsibilities. The outcome is consistent with Horstmeyer (2011) who asserted that large size nomination committee was negatively related to outside director turnover. For this reason Tosi et al. (2003) are of the view that a dysfunctional nomination committee reduces the board to a "rubber stamp" board where the selection of members is controlled by the CEO though outwardly the board appears to be quality. The result is a confirmation of the fear expressed by Higgs (2003) when assessing the effectiveness of outside directors in UK that CG should not be seen as a "box ticking" exercise of having seemingly board structures and mechanisms, but rather a working system which ensures maximum oversight for value creation.

Remuneration committee (RC) has a positive effect on financial performance but it is statistically insignificant for both measures of performance. The result is consistent with the findings of Kato and Long, (2006) who found positive relationship between the executive remuneration and CFP and attributed the effect to the vigilance of the remuneration committee after investigating the relationship between corporate governance and financial performance of 937 listed firms from 1998 to 2002 in China. Additionally, the outcome can be liken to the Sun et al (2009) who exposed that the quality of the compensation committee accounted for the alignment of CEO compensation to CFP. Their findings also bring to fore the close relationship between the agency and the resource

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dependency theory in the sense that the quality of outside directors on the committee go a long way in providing the necessary leadership for effective monitoring of executive pay. Critics of executive pay frequently asserts that CEO pay is not sufficiently linked to corporate financial performance, suggesting that remuneration committees often do not factor shareholders interest in the fixation of executive remuneration. However after the publication of the seminar article by Jensen and Murphy (1990) the executive remuneration landscape has radically changed. Given the complexity of remuneration issues concerning allowances, long term incentive plans, stock options, bonuses, compensation for loss of office etc the remuneration committee must be composed of majority outside directors with the requisite knowledge and experience in human resource management to craft executive remuneration in such a manner that shareholders' value maximization are taken into consideration (Hannigan, 2015). Also since these activities are time consuming exercise the remuneration committee must make time for such important assignment to avoid the overly dependent on remuneration consultants. In situations where consultants are used to navigate such difficult issues full disclosure must be given to determine the scope of the relationship including the terms of engagement and fees (Hannigan, 2015).

The coefficient of the interaction of audit committee on performance was negative when performance measure ROE was used but positive with regards to ROA, however both performance indicators were statistically insignificant. Summarily, the above results can be explained that audit committee has no effect on financial performance, meaning that the oversight responsibility expected of the audit committee in the areas of internal control, financial reporting and disclosure process, appointment of external auditor to strengthen financial governance were lacking. The result is similar to Yahya et al. (2012) who revealed among Saudi Arabian listed companies that the presence of audit committee could not mitigate the agency problem and hence the effect of audit committee on financial performance was found to be negative. Recently, audit committees have become popular due to the number of corporate scandals (e.g. Enron, 2001 and Worldcom, 2002). The roles and responsibilities of audit committees have equally become challenging (Mohammed and Hussain, 2007) to the extent that the concept of mandatory audit committee on the boards have received blessing from the corporate world as a panacea towards effective financial governance. Both legislative and code specific CG frameworks have welcomed the concept of mandatory audit committee (ASX Guideline, 2003; Sarbanes-Oxley Act (SOX) 2002) because of the general idea that the presence of such committee with the right composition of outside directors and financial expertise can prevent opportunism on the part of management through free, fair and transparent financial reporting. In the UK, the Sharman Inquiry Report on Going Concern and Liquidity (2012) has suggested that to improve the financial governance of listed companies there should be reinforced triangular relationship between the audit committee, auditors and the board where the audit committee must be involved extensively in the exchange of information, monitoring and review of issues related to internal audit, appointment and remuneration of external auditors among others.

Other variables such as Board Size has a positive effect on corporate financial performance and it is statistically significant at 5% level when performance is measured by ROE. The outcome can contradict the findings of (Hermalin and Weisbach, 2003; Huther, 1997; Cheng et al., 2007; Coles et al., 2008). Frequency of board meetings also regressed negatively but insignificant on both performance measures. The results is consistent with Vefeas (1999) who reported negative

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relationship between frequency of board meeting and financial performance using Tobin's Q as performance proxy in 307 listed US companies from 1990-94. Lastly, shareholder concentration has a positive effect on ROE consistent with (McConnell and Servaes, 1990 & Weigand, 2003) respectively.

CONCLUSION AND RECOMMENDATION

The objective of examining the effect of board committees' on corporate financial performance among Ghanaian listed companies concludes that the nomination committee regressed negatively on corporate financial performance with the audit committee having no effect whiles the remuneration committee affected corporate financial performance positively. Conclusively, the result point out to the fact that the effective inner workings of listed boards are abysmal, thereby questioning the caliber and suitability of outside directors on these committees. Consistently, the author recommends that the selection process of outside directors into these board committees be strengthen to provide the required oversight responsibility expected by these committee to improve the quality of corporate governance. Perhaps the suggestion by Hannigan, (2015) that the responsibilities of outside directors have become complicated and combining post at a number of companies becomes increasingly problematic should be carefully considered.

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