

Does Structural Power Matter? Board Attributes and Firm Performance: Moderated by CEO Duality

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Purpose- The study investigates the moderating role of Chief Executive Officer Duality onboard attributes and firm performance of companies listed in Kenya.

Design/Methodology- The research used a longitudinal research design. Panel data were derived from published accounts for sixteen years that is from 2002-2017. IGLS regression models were used to test the hypothesis.

Findings- The empirical results indicated that the independence of the board, the size of the board, and the duration in which the board member served the organization positively influence the firm performance. However, CEO duality does not moderate the relationship.

Practical Implications- Regulatory bodies such as NSE and CMA in Kenya should ensure that listed firms have more independent directors serving a board, ensure a reasonable size of the board and increase the board tenure to enhance firm performance. Further, the combined roles of the CEO and chairman may not influence the efficiency of the board in the Kenyan context.

Introduction

Firm performance encompasses the ability of an organization to maximize the shareholders' wealth and thus increase the firm value (Sarhan, Ntim, & Al-Najjar, 2019). However, in recent years financial crises, economic collapse, and fall of large corporations have resulted in investors of the firms to endure severe losses (Martín & Herrero, 2018). Hence, this has brought corporate governance to the limelight, especially about the board's function in safeguarding the owners of capital wealth.

Agency theory emphasizes having on board directors who can monitor and control the management, discipline the managers and ratify and approve significant decisions that enhance the increase in the value of the firm (Katti & Raithatha, 2018). However, board ineffectiveness has mostly been associated with the structural power that a CEO has been conferred (Boyd, 1995; Duru, Iyengar, & Zampelli, 2016; Harjoto, Laksmana, & Lee, 2015; Ntim, 2016). As such, the subject of CEO duality has been a matter of contention in accounting and finance literature.

Although previous studies have extensively researched on board attributes and firm performance, the results are inconclusive. While studies have shown positive relationships between board attributes and firm performance (Han, Nanda, & Silveri, 2016; Sarhan et al., 2019), others have shown negative relationships (Boyd, 1995; Duru et al., 2016; Garkaz, Abdollahi, Niknam, & Branch, 2016; Martín & Herrero, 2018). Whereas, there are studies which have not shown significant relationships (Sheikh, Shah, & Akbar, 2018). The reason that can explain the variability of the results is the legal and institutional settings, which is quite different in developed and emerging countries such as Kenya. Hence the need to conduct the study in Kenya.

In addition to the mixed results, although prior research has expanded more on different board attributes and firm performance, little is known about the influence of the CEO power on the effectiveness of the board toward enhancing performance. Studies have shown that CEOs can have powers over the company's functions and effectiveness since the approval of most decisions depends on them. Other studies have further shown that Chief Executive Officers can also influence how directors are appointed, thus compromising independence and board functioning. Thus, this research furthers extant literature by investigating the moderating role of Chief Executive Officer structural power as determined by CEO duality on the relationship between board attributes and firm performance in Kenya.

Theory and Hypotheses Development

This research was anchored on both agency theory and stewardship theory. While agency theory views executive managers as opportunists and thus the need for the shareholders to appoint the board to monitor and control such managerial opportunistic activities, stewardship theory views managers as custodians and stewards who are motivated to serve the same interest as the owners of capital. Agency theory assumes that the agents understand more about the company than the owners; hence they can decide to serve their interest if proper monitoring and control are not put in place. It, therefore, advocates that a thin layer in the form of a board should be introduced to curtail such opportunistic behaviors. Previous research has established that boards are instrumental in the decision making process.

Nonetheless, there is a debate in prior literature on identifying the optimal attributes that the firm should have to ensure efficiency. Further, CEOs form part of the board and are in charge of the day to day running of the business. In circumstances where firms practice duality, CEOs may have unvetted powers. The repercussion of these powers has been explained in different versions by the agency theory and stewardship theory. Agency theory posits that introducing the board of directors will aid in monitoring managerial activities and approving decisions of the management and hiring and firing senior management, especially the Chief Executive Officer. Unfortunately, some studies reveal that the CEOs have more powers and thus affect the effectiveness of the

board. In that case, they ensure that they create a friendly board that cannot question their work. Stewardship theory, on the other hand, assumes that Chief Executive Officer understands his/her duties and works towards achieving the shareholder's goals, thus need not be monitored. Therefore, the study sought to understand whether CEOs in Kenya context, with duality powers, work as agents as posited by the agency theory or work better as stewards as explained by stewardship theory.

Board Attributes and Firm Performance

The board of directors acts as monitoring mechanisms that reduce the scrimmage between the owners of capital and the managers. The more power the board holds, the less likely the probability of opportunistic behaviors by the managers. Put simply, when the monitoring by the board is not adequate, it augments the ability of the agents to dissipate the shareholders' resources (Al-Matari, Al-Swidi, & Faudziah, 2014; Naseem, Xiaoming, Riaz, & Rehman, 2017; Sadeghi Panah & Boroumand, 2015). The board of directors' oversight ability roles becomes straightforward and easy to implement by splitting the CEO and chairman role independently. The independency dilutes the CEO's power and increases the board of directors' effectiveness to perform their oversight role. To enhance independence, some of the internal mechanisms employed are the concern of increasing representation of outside independent non-executive directors and having a large board. Large boards are hard to be controlled by the CEO contrary to small boards but interfere with group dynamics (Jensen, 1993). Thus, the board attributes in this study refer to the size of the board, board independence, and board tenure.

Board independence and firm performance

Independent directors refer to directors who are not affiliated with the organization in any manner. Independent directors have been viewed by literature as more efficient in increasing the firms' value (Smulowitz, Becerra, & Mayo, 2019). This has been associated with the vast expertise they gather from holding multiple boards. The other set of literature argues that independent directors have less information and may not be conversant with the company's operations, thus may not be reliable in increasing the firms' value. Further, there is an ongoing debate in the literature on board independence and its impact on firm value. Several scholars reckon that independent directors are not independent in their decision makings. Instead, they act according to the interest of the sizeable net-worth shareholder that holds a significant say in the performance of the company. Notwithstanding that, independent directors control the activities of the firm at all levels and even hold power to appoint and dismiss top-level managers in the best interest of the organization at any point in time (Naseem et al., 2017).

Earlier studies have shown varied results about the relationship between the board of directors' independence and the performance of a firm. One stream of literature has shown that there exists a positive relationship between board independence and firm performance (Han et al., 2016; Sarhan et al., 2019). The other stream has established a negative association between board independence and firm performance (Duru et al., 2016; Martín & Herrero, 2018). Contrary to these results, Pervin and Rashid (2019) did not establish any significant relationship between the independence of the board and firm performance. Thus, advancing from the inconclusive results, we hypothesize that;

Ho1: There exists a positive and significant relationship between board independence and firm performance

Board size and firm performance

Board size refers to the number of directors serving the given organization (Hoppmann, Naegele, & Girod, 2019). While agency theory advocates for smaller boards that allows easy coordination and minimum cost, resource dependency theory argues that long-tenured boards are more versed as they incorporate more expertise in different disciplines and a further increase of independent board members (Kalsie & Shrivastav, 2016).

Specifically, the corporate governance guidelines issued in 2002 by Capital Market Authorities in Kenya requires that all listed firms should have board members of sufficient size. The word “sufficient size” does not give the exact required number of board members, but instead, it leaves it open for companies to incorporate members whom they feel is sufficient to serve the board. Thus, it is clear that the sizes of the boards will vary across the firms depending on the size of the firms and the nature of the business.

Scholars in finance have shown mixed results on the relationships between the size of the board and firm performance. A stream of literature has echoed that large boards increase firms’ value due to collaborative expertise that is acquired from experienced board members, the inability of the CEO to manipulate large boards due to different personalities, and the fact that it increases the possibility of inclusion of more independent board members (Merendino & Sarens, 2020). Other studies have argued that smaller boards are more efficient in increasing firm value in that it reduces costs and dormant members, enhances easy coordination, and provides board cohesion (Kao, Hodgkinson, & Jaafar, 2019). Hence it is not clear from the literature whether firms should go for smaller boards or large boards. Thus, advancing from the inconclusive results, we hypothesize that;

Ho2: There exists a positive and significant relationship between board size and firm performance.

Board Tenure and Firm Performance

Tenure of the board refers to the duration in which board members have served the board. When board members are allowed to serve for a more extended period, they tend to understand the operations of the company more and thus become more productive in decisions they make of the company, considering that they understand the industry better. Other sets of literature argue that when board members are allowed to serve for a more extended period, independency is compromised (Neville, Byron, Post, & Ward, 2019). Thus, they argue that shorter serving directors are better since it allows rotation of directors allowing those with low performance to be replaced by more productive and efficient directors. Further, the literature argues that it allows the distribution of expertise and knowledge gathered from serving other boards (Neville et al., 2019).

Scholars have shown contradictory results on the association between board tenure and firm performance. In two studies, the results yielded a positive relationship (Sarhan et al., 2019; Sheikh et al., 2018). These studies argued that long-tenured boards are more informed and understand the firm’s systems hence cannot be controlled by the management. Other studies have yielded negative relationships (Al-Matari et al., 2014; Boyd, 1995). These studies have further echoed that board tenure acts as a proxy of board independence, and thus the longer the period a board member serves, the lower the board's independence.

Interestingly, others have shown no significant relationships between board tenure and firm performance (Saleh, Latif, Bakar, & Maigoshi, 2020). Hence from the literature, it is unclear how a director should serve and remain productive to enhance firm value. Thus, advancing from the contradicting results, we hypothesize that;

Ho3: There exists a positive and significant relationship between board tenure and firm performance

Moderating Effect of CEO Duality on the relationship between board attributes and firm performance

CEO duality has been defined as a state in which the Chief Executive Officer not only heads the company’s operation but also chairs the board. Studies have referred this to as a double-edged sword. There are two conflicting theories on CEO duality. While agency theory advocates that the powers should be separated so that it can allow the board to control the CEO, stewardship theory views the CEO as a steward and a responsible executive who is ready to serve the interest of the owners of capital (Adams & Jiang, 2020; Kim, Al-Shammari, Kim, & Lee, 2009; Saleh et al., 2020)

The efficiency of the board depends on the powers that the CEO has over the board. While it is expected that the board should vet the powers of the CEO, this may not be the case, especially where he holds the two roles (Tang, 2017). In fact, in the case of duality, it means the CEO participates in the nomination of the directors. In such a case, they may choose a friendly board that he/she can efficiently work with. Secondly, the independence of the directors will tend to be compromised in fear of the contracts not being renewed. Thus, to establish the moderating effect of CEOs structural power on the relationship between boards attributes and firm performance, we hypothesized that;

Ho4a CEO Duality does not moderate the relationship between board independence and firm performance

Ho4b CEO Duality does not moderate the relationship between board size and firm performance

Ho4c CEO Duality does not moderate the relationship between board tenure and firm performance

Conceptual Framework

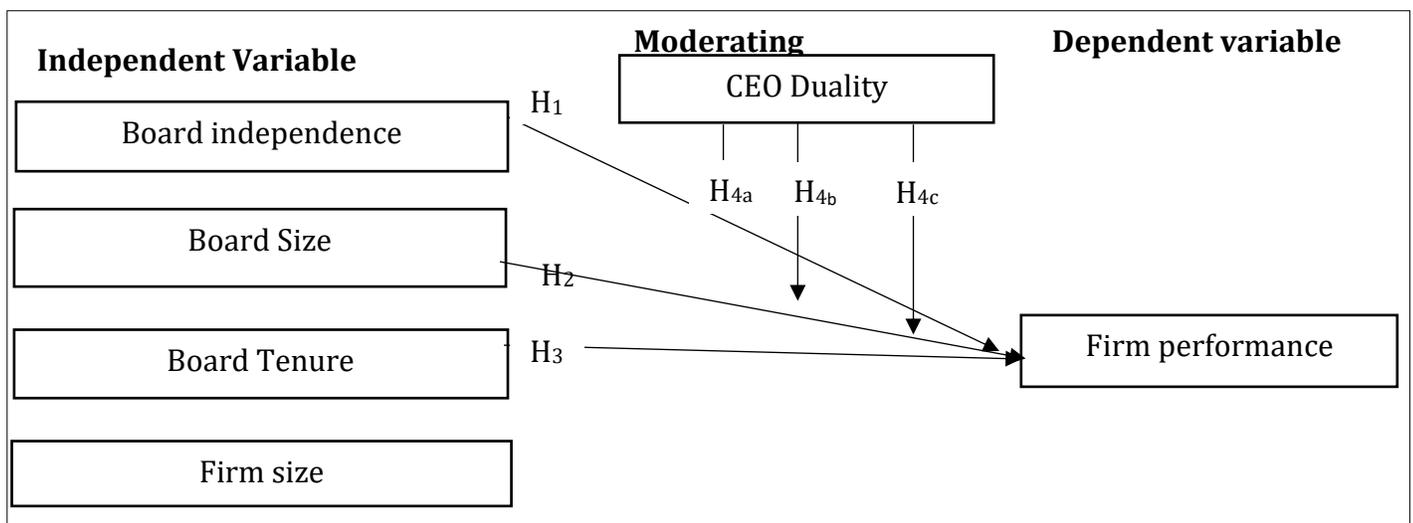


Figure 1 - Conceptual Framework of the Study

Research Methodology

The data were derived from published financial statements of listed firms in Kenya. The longitudinal research design was adopted in this research, targeting 51 firms actively trading at NSE between 2002 and 2017. Thus, the census approach was adopted.

Measurement of Variables

Dependent Variable

Firm performance refers to organizational effectiveness in utilizing the company’s resources to consistently improve capabilities and abilities to meet the company goals. Previous research has measured performance using ROA and ROE (Buallay, Hamdan, & Zureigat, 2017; Lamb, 2017). Hence the current study adopted the measurements used by Subedi (2018) in measuring firm performance using a return on equity.

Independent variables

Board independence refers to where a director does not have a relationship with the company except as a director. The study followed Klettner, Clarke, and Boersma (2014) by measuring board independence as a proportion of seats held by neutral directors.

Board size referred to the aggregate directors in a given board. The study adopted Ntim (2016) by measuring board size as the composite of individuals serving a given board at a given time.

Board tenure refers to the period a director has served as a board member in an organization. The study followed Chan, Liu, and Sun (2013) approach by considering directors who have been in the organization for less than one year by converting duration into monthly equivalence.

Moderating Variable

Chief Executive Officer duality was defined as a combination of roles of board chair and CEO duties. This was measured as a dummy variable set to one if it existed; if not, then zero was denoted.

Control Variables

The variable that had shown influence on the dependent variable was controlled. That is firm size. This was measured as the natural log of total assets worth (Li, 2016).

Table 1: Measurement of variables

	Measurement
Endogenous Variable	
Firm performance	Measured using a return on equity (ROE)
Exogenous Variables	
Independence of the board	Number of independent directors serving a board
Tenure of the board	A period in which a board member as served the board.
Size of the board	The total number of directors serving a board.
Moderating Variable	
CEO Duality	The dummy variable set as to1 if there is CEO duality; otherwise, zero
Control Variables	
Firm size	Natural logarithm of total assets.

Regression Models

The models for this study were then specified as follows;

Model 1 presented the relationship between control variables and the dependent variable

$$Firper_{it} = \beta_0 + \beta_1 Firsiz_{e_{it}} + \epsilon_{it} \dots \dots \dots \text{Model1}$$

Model 2 presented the introduction of the direct effects

$$Firper_{it} = \beta_0 + \beta_1 Firsiz_{e_{it}} + \beta_2 Boinde_{it} + \beta_3 Bosize_{it} + \beta_4 Boten_{it} + \epsilon_{it} \dots \dots \dots \text{Model 2}$$

Model 3 presented the introduction of the interaction effects

$$Firper_{it} = \beta_0 + \beta_1 Firsiz_{e_{it}} + \beta_2 Boinde_{it} + \beta_3 Bosize_{it} + \beta_4 Boten_{it} + \beta_5 Ceodual_{it} + \beta_6 Boinde_{it} * Ceodual_{it} + \beta_7 Bosize_{it} * Ceodual_{it} + \beta_8 Boten_{it} * Ceodual_{it} + \epsilon_{it} \dots \dots \dots \text{Model3}$$

Where;

Firper (Firm performance) Firsiz (Firm size) Boinde(Board independence), Bosize(Board size) Boten(Board tenure) CEOdual (CEO Duality)

Results

Descriptive statistics results showed that the average mean for the firm performance was 0.061 between and within the variation of 0.081 and 0.113, respectively. Board independence showed an overall mean of 0.821, meaning that at least 80% of the directors were independent. Board tenure showed that at least directors served for 10.923 years. The size of the boards showed an average mean of 9.37, while CEO duality and firm size showed an average mean of 0.015 and 16.27, respectively. However, none of the study variables showed a significant correlation with firm performance.

Before the regression model was fitted to test the hypothesis, it was necessary to carry out panel diagnostic tests and check for regression assumptions. First, all the variables were checked for panel stationarity, and the results had p values less than 0.05 indicating that all study variables exhibited panel stationarity. Hausman test carried out had p- values greater than 0.05, indicating that REM was the preferred model. Breusch Pagan, Langrange multiplier test also indicated that the data had panel effects.

Both model specification tests warranted the adoption of the random effects model as opposed to the fixed or pooled effect models. Since REM produce biased estimators in cases of unbalanced data, Swamy-Arora estimators were adopted. To adopt the results of the swamy-arora random effect estimates, further diagnostic tests were carried out on the model fitted. Table 2 presents the model diagnostic test results undertaken to check whether the model met or violated the classical linear model assumptions of random effect models.

Table 2: Diagnosis of model assumptions

Assumption/ Purpose	Test	Test statistic	P-value	Conclusion
Non-Serial correlation	Breusch-Godfrey/Wooldridge	F (1, 49) = 1.759	.1909	Not violated
Homoscedasticity	Wald	Chi2(52) = 3.05e+08	.0000	Assumption violated
Normality test (within)	JB test	chi2(2) = 3.52	.1719	Not violated
Normality test (between)	JB test	chi2(2) = 2.73	.2549	Not violated
Cross-sectional independence	Friedman test	Pesaran's Z = 1.140,	1.0000	Not violated

Since the model violated the homoscedasticity assumption, Integrated Generalized Least squares were used to take care of the heteroscedastic errors. Model 1 presented the relationship between the control variable and the dependent variable. Firm size showed a significant positive effect ($\beta = 0.010$, $p < .05$) with firm performance. Model 2 presented the relationship between control variables and dependent variables. Thus, the results were used to answer H_{01} , H_{02} , and H_{03} . H_{01} presupposed that there exists a positive and significant relationship between board independence and firm performance. The results showed board independence had a positive and significant relationship with firm performance ($\beta = .065$, $p < .05$). Thus, the hypothesis failed to be rejected.

H_{02} proposed that there exists a positive and significant relationship between board size and firm performance. The results showed that board size had a positive and significant effect on firm performance ($\beta = .011$, $p < .05$). Hence the hypothesis failed to be rejected. H_{03} presumed that there exists a positive and significant relationship between board tenure and firm performance. The results showed that board tenure had a positive and significant relationship with firm performance ($\beta = .013$, $p < .05$). Thus, the hypothesis failed to be rejected. Model 3 presented the introduction of the moderating variable together with interaction terms to test the

moderating effect of CEO duality on the relationship between board attributes and firm performance. Thus, the results were meant to answer H_{o4a} , H_{o4b} , and H_{o4c} . The coefficient estimates of the additional interaction terms showed no significance. Board independence interaction CEO duality showed ($\beta = -.518; p > .05$), Board size interaction CEO duality showed ($\beta = -.093; p > .05$) while Board tenure interaction CEO duality showed ($\beta = .049; p > .05$). Thus, it is deduced that CEO duality does not have a moderating effect on the relationship between board independence, board size, board tenure, and firm performance. The hierarchical results have been shown in the table below.

Table 3: Hierarchical Results

Variables	Model 1 Estimates	Model 2 Estimates	Model 3 Estimates
Intercept	-.319 (0.000)	-0.319 (0.000)	-0.318 (0.000)
Control Variable			
Firm Size	.010 (0.000)**	.010 (0.000)**	0.010 (0.000)**
Main Effects			
Board Independence		.065 (0.008)**	0.065 (0.005)**
Board Tenure		.013 (0.000)**	0.013(0.000)**
Board Size		.011 (0.000)**	0.011(0.000)**
Moderating variable			
CEO duality			0.693 (0.621)
Interaction effects			
Board independence interaction CEO duality			-0.518 (0.465)
Board tenure interaction CEO duality			0.049 (0.370)
Board size interaction CEO duality			-0.093 (0.548)
Summary statistics			
Loglikelihood	14.016	16.120	16.556
Chi-square	120.67 (0.000)	125.71 (0.000)	126.75 (0.000)
Likelihood ratio change (LR)		4.21 (0.0403)	0.87 (0.831)
AIC (Akaike's information criterion)	81.966	79.759	84.886
BIC (Bayesian information criterion)	334.875	334.620	353.400

Discussion

The study sought to establish how CEO structural power can influence the board's effectiveness in enhancing firm performance. The findings showed that increasing the independent members on the board would increase the board's effectiveness in enhancing firm value. This can be attributed to the fact that independent board members do not have any attachment to the company except the directorship role. Hence they would do their best to increase the firm's wealth. Secondly, they value their reputation because of the market; thus, they would do their best to increase their reputation. This result echoes the findings of Ciftci, Tatoglu, Wood, Demirbag, and Zaim (2019), who contended that when more independent directors are included in the board, an organization improves. Other studies that have been supported by the findings include (Fernandes, Farinha, Martins, & Mateus, 2017; Oteng-Abayie, Affram, & Mensah, 2018). The size of the board was also found to be influencing the performance of the organization, thus supporting the resource dependency theory. The reason attributed to this is because, as the board size is increased, it enhances the probability of increasing the inclusion of more expertise and more independent directors on the board. The results support the findings of Saleh et al. (2020) and Kalsie and Shrivastav (2016), who argued that when the membership of the board

members is increased, it increases firm performance. Board tenure was also found to be influencing firm performance positively. The main reason attributing to this is that as the board members serve a firm for a more extended period, they tend to understand its operations well. As such, they become more productive as compared to the shorter periods. These findings echo the study of Amaoko and Goh (2015) who found that increasing the board tenure proportionately increases the firms' profitability. The moderating effect of the Chief executive duality was however found to be insignificant and thus have no influence on boards' characteristics in increasing the firm value. Thus, the findings support the stewardship theory prepositions that managers are good stewards and thus focus in serving the interest of the owners of capital.

Conclusion

While it is widely accepted that good corporate governance is pertinent in the growth and performance of modern firms, the jury on CEO duality is still out. While some scholars are in favor of a firm's governance structure which upholds CEO duality because it allows for executive teams to run firms with clear leadership, thus facilitating effective communication between shareholders and investors, other researchers are vehemently against CEO duality governance structure by the claim that a CEO might become too powerful and unfavorably influence the monitoring function of the board. Thus, interfering with a board's oversight effectiveness and firm performance. It then suffices that there is neither right nor wrong board structure. However, investors and stakeholders are more persuaded to separate the roles to enhance independence and transparency.

Theoretical implications

The findings of this study add to the extant literature by providing other board constructs that can enhance firm value. Further, the moderating effect of structural power is established. Thus, it is evident that in the Kenyan setup, an increase in the membership of the independent board, increasing the board sizes, and the tenure of the directors increases firm value. However, the structural power of the CEO cannot change the efficiency of the board.

Practical implications

Kenyan listed firms should consider incorporating more independent directors, which increases the size of the board. Further, they should increase the period in which a director can serve a firm to increase efficiency and firm value.

Policy implications

The Capital Market Authorities in Kenya should consider revising the board requirements on the independence of the boards, tenure, and size as per the findings of this study. Moreover, delinking the powers of the Board Chair and CEO should not be mandatory, especially for the small growing firms.

Recommendations for further research

The research will act as a springboard for scholars in this field to build on and extend the outcomes of this study. Future studies should establish the relationship of other board constructs such as board diversity, multiple directorships, board educational diversity, or the board functional diversity and firm profitability. Also, the same study can be replicated to non-listed companies, NGOs, and family-owned businesses.

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