IJHER International Journal of Humanities and Educational Research
ISSN: 2757-5403
Volume 4, Issue 4, August 2022

Received: 12/06/2022 **Accepted:** 05/07/2022 **Published:** 01/08/2022

BOARD COMPOSITION EFFECTIVENESS ON CORPORATE PERFORMANCE DIRECTLY AND THROUGH EARNING MANAGEMENT

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Abstract

The corporate performance to be reached, there are many boards should be included through operating firms activities. But existing such challenges still face many corporations. Furthermore, implementing corporate social responsibility in order to catch up the corporate performance still quite difficult, especially in developing countries where the earning management remains in financial statements which causes asymmetric information. Thus, this study tries to investigate and analyze the effectiveness of board composition (board size, board meeting, board diversity) as independence variables on (earning management) as intervening variable in order to reach (corporate performance) as dependent variable, and the smart PLS is the great statistical technique has been used to analyze secondary data collected from annual reports of such firms which are under agriculture field. The out coming showed that composition board (board size – board meeting – board diversity) have a significant effect on corporate performance directly and through out earning management.

Key words: Board Composition, Earning Management and Corporate Performance.

http: //dx.doi.org/10.47832/2757-5403.15.27

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Introduction

The corporate performance to be reached, there are many boards should be included through operating firms activities. But existing such challenges still face many corporations. Furthermore, implementing corporate social responsibility in order to catch up the corporate performance still quite difficult, especially in developing countries. Thus, corporate social responsibility (CSR) has been defined as various activities which can be operated through firms to make balance between treble bottom lines phenomena. But, slightly understanding of CSR appropriate occur some weakness of improving the CSR reports which also lead to decreasing of corporate performance. In developed countries KPMG research later on demonstrated that up to 80 % of 250 largest companies in the world indicate in their reports the corporate social responsibility by the end of every single financial year by explaining incentive activities through three appropriate patterns (KPMG, 2008.p.4-9). These days concerning of corporate performance phenomena become the back vertical for any organization in the world which is requested by managers and shareholders as well (Acer, 2012 ; Pimentel & Major, 2014). For instance, managers in some companies such as Gas and Oil companies has got financial crisis but the managers tried to play with earning management in order to rise up the confidence of some stakeholders. Furthermore, several techniques can be implemented in corporations to have or maintaining the same corporate performance (Neely, Mills, Plats, Gregory & Richards, 1994).

More concerning, organizations in political, economic or legal improving their behavior to be capable to gain the support from stakeholders and their attention as well. Barnetts, (2007) indicated that managers promoting sustainable can use CSR activities as discretionary activities leading to go over their own welfare and benefits. Actually, this study conducted to put the light on the effectiveness of board composition (board size, board meeting and board diversity) on earning management in order to corporate performance.

Research Problem

In deep last decades has been notified that the majority of firms whether energy or agriculture indicated less performance but later on the corporate performance has grown up to be satisfied by the firms in these decades. So, the researcher tried to candidate and investigate the main reason of increasing the corporate performance of firms. Where, the researcher paid appropriate attention to the board composition (board size, board meeting and board diversity) which probability could influence on corporate performance.

Literature review and hypothesis development

Freeman, Wicks and Parmar (2004) considered that stakeholders theory should push mangers to make evidence and clearance about how will they operate their business, in other words, what sort of relationship should be have with stakeholders in order to reach their purpose. So, implementing stakeholders theory can assist organizations to be survive and reaching the summit of economics by controlling sustainable activities and that related to its strong concentration. Gray et al ,(1995) indicated that the largest companies in the world, especially, in developed world has the ability to start and focus on sustainability reports which is the measurement of corporate social responsibility disclosure and also concerning of sustainable reports depends on the powerful of stakeholders, the appropriate of stakeholders can increase the financial reports which reflected on corporate performance where this can ensure the positive relationship between the corporate social responsibility and financial performance.

Fama & Jensen , (1983) demonstrated that Agency theory depends on the possibility that when an organization is first settled, its proprietors are generally additionally its directors. As an organization develops, the proprietors delegate administrators to run the organization. The proprietors anticipate that the directors should run the organization to the greatest advantage of the proprietors; in this way a type of organization relationship exists between the owners and the managers. Agency theory shows that the managers operate the activities to their self-interest and ignore the shareholders interest. For instance, the manager who works for a long time in specific company, in other words who is more experience than others can guide the benefits to himself without concerning of shareholder interests, in other side, that situation will cost the company such as behavior cost and structuring cost. Furthermore, the agency theory suggested to implement such tow basic mechanisms external and internal which are board of directors and compensation schemes in order to align between managers and stakeholders such as board size, board independence and gender diversity where the last emphasize that has the ability to destroy building earning management.

1-Board Size

The actual meaning of board size is that how many members of directors included in the firm to discuss and develop the issues which faces the corporate, Jensen , (1993) indicated that the numbers of directors should expand beyond 7 or 8 members to be easy for them to have more meeting with more benefit, meanwhile, Lorsch (1997) suggested that the number of members should be 12 members of directors to prevent the corporate from destroying and be survive for a long term. For instance, the board size construct has a liner relationship with the firm size where, the small firms have a little members of directors but the firm size is not the only variable which effect on board size of directors where there are such other variables such as firm age, managerial ownership and etc. (Boone, Field, Karpoff and Raheja 2007). According to the previous discussion I can formulate the hypothesis as shown below:

H1a: The board size has a significant relationship with the corporate performance of the firm.

H1b: The earning management will increase the relationship between the board size and corporate performance of the firm.

2-Board Meeting

Board meeting means that the directors should meet in various time during the year to discuss the issues and sort the obstacles out in order to enhance the professional of financial statements to be away from fraud (Vafeas , 1999). Furthermore, Lipton & Lorsch , (1992) established that board meeting has associated with coast such as directors fee and travel expenses and that cost will increase by increasing of meeting time, the directors who meet frequently are more likely to meet their duties in time and catch up the corporate performance. Hermanson and Lapides (2000) enhanced that less meeting will provide possibility of outstanding of fraud statements, which demonstrate that multiple meeting prevent the corporate performance. According to the previous discussion I can formulate the hypothesis as shown below:

H2a: The board meeting has a significant relationship with the corporate performance of the firm.

H2b: The earning management will increase the relationship between the board meeting and corporate performance of the firm.

3-Board Diversity

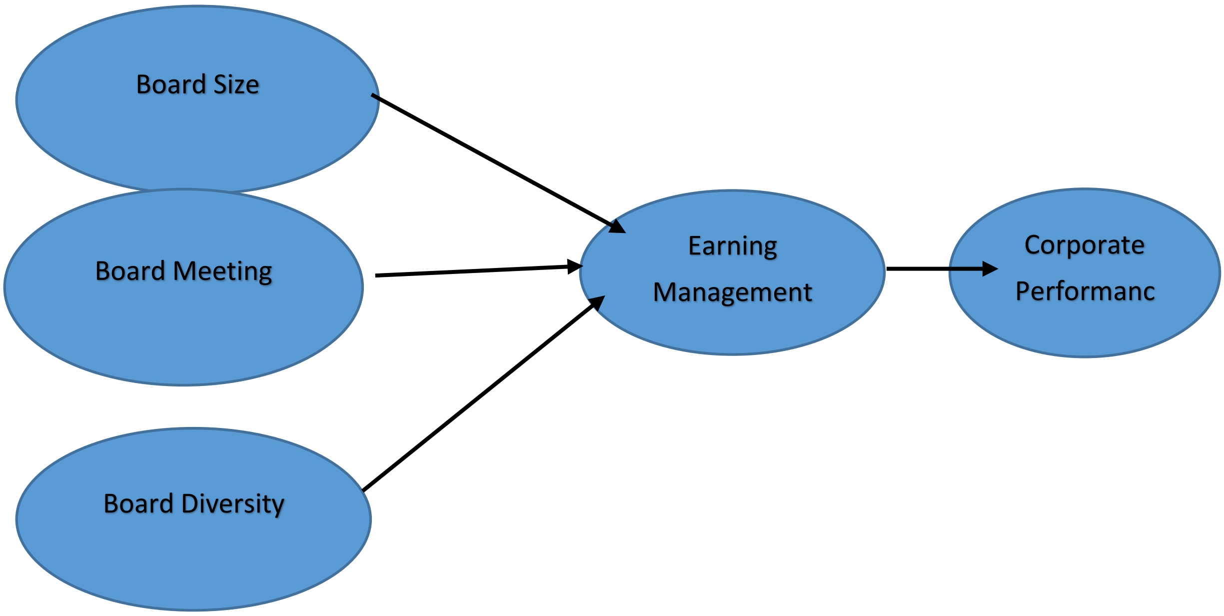
In total this pattern focus on specific four forms which are age, gender, nationality and education degree but in this study the researcher will focus just on the gender. For instance, the gender diversity has an important role to improve and invisible the right dynamic of firms as well as to prevent the corporate from earning management in order to protect the investors from asymmetric information. So, the majority of previous studies have enhanced that there is a significant relationship between the board diversity and corporate performance, where, the minority informed that there is no significant relationship as such studies combined in china (Adams & Ferreira, 2009).

Furthermore, the hypothesis can be formulated as shown below:

H3a: The board diversity has a significant relationship with the corporate performance of the firm.

H3b: The earning management will increase the relationship between the board diversity and corporate performance of the firm.

Research Framework



Research Method

The smart Partial Least Square (PLS) is a great technique to analyze quantitative data collection, where this program can out stand accurate results especially, in investigating predictive relationship. For instance, the population of this study is considered in global agriculture corporation where the sample is just ten firms for a period one year in (2007) which called a pool technique and the secondary data such as annual reports are accurate to expect the predictive relationship. In addition, the board composition will be measured as demonstrated below:

- **Board size:** the researcher accounted the number of directors in each single sample firm included the CEO and chairman.
- **Board meeting:** the researcher in this pattern depended on the number of directors meeting during the financial year.
- **Board diversity:** the researcher measured this construct according to the number of women included in the firm.

Finding and conclusion

In this pattern, the researcher has focused on the t-value and compared it with 1.645 because the hypothesis in this study is just one – tail. For instance, the results of this study divided in to parts where the first part demonstrated the impact of composition board directly on corporate performance and the second part demonstrated the impact after adding the moderating variable (Earning management).

Investigating Hypothesis before Adding the Moderating Variable (Earning Management)

Hypothesis	Variables	Coefficient	T Statistics (|O/STERR|)	Results
H1	**Board Size -> Corporate performance**	0.127343	1.661524	**Supported**
H2	**Board Meeting -> Corporate performance**	0.345457	1.826333	**Supported**
H3	**Board Diversity -> Corporate performance**	0.234730	1.749881	**Supported**

According to the previous table explained the hypothesis out coming before adding Earning Management as moderating variable. Furthermore, it is clearly that the (board size – board meeting – board diversity) has a significant effect on corporate performance as well as the path coefficient enhanced the significant impact on the corporate performance.

Investigating Hypothesis after Adding the Moderating Variable (Earning Management)

Hypothesis	Variables	Coefficient	T Statistics (|O/STERR|)	Results
H1	**BS -> CP**	1.355697	2.553521	***Supported***
H1.a	**BS * EM -> CP**	0.743988	2.441366	***Supported***
H2	**BM -> CP**	1.054447	1.677138	**Supported**
H2.a	**BM * EM -> CP**	1.653900	2.118937	***Supported***
H3	**BD-> CP**	-0.243756	1.734865	***Supported***
H3.a	**BD * EM -> CP**	0.324156	2.005617	***Supported***

By looking to the above table, it shows that the moderating variable (earning management) has increased the significant relationship between independent variables (board size – board meeting – board diversity) and the dependent variable (corporate performance). For instance, the T- test is more than 1.645 at all hypothesis which enhance the significant relationship between all variables conducted in this study. Meanwhile, many various studies showed significant relationships as the same as this study in a different population and different time of conducting data.

Conclusion

According to the analyzing data by testing hypothesis. It is for sure to have a really attention of having a completely understanding of corporate performance. For instance, conducting data and analyze it by using a great statistic technique of partial least square (smart PLS), this study found that the board compositions (board size – board meeting – board diversity) have a significant effect on corporate performance directly and through a moderating variable (earning management). Eventually, this study supported by stakeholders theory and agency theory.

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