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Optimizing Board Structure for Enhanced Firm Value: A Conceptual Framework

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Abstract
This conceptual paper aims to develop a framework for optimizing board structure to enhance firm value. By synthesizing theoretical perspectives, empirical research, and best practices, the study proposes a comprehensive framework that integrates key elements of board structure and their impact on firm value creation. The study adopts a systematic literature-based methodology. The framework encompasses board composition, independence, diversity, size, committee, and leadership roles, with a focus on aligning these dimensions with the strategic objectives and unique characteristics of the firm. Findings from the literature, re-iterates that board structure is an important factor in determining the firm value. Strategic decision making, risk management and oversight, succession planning and leadership development, external relations and investor confidence, as well as regulatory compliance were proposed as mechanisms to facilitate the attainment of optimal board structure for enhancement of firm value. The paper provides a conceptual road-map for corporate boards, executives, and policymakers to strategically design and optimize board structures that maximize firm value.

Keywords: Board structure, composition, independence, diversity, size, firm value

1. Introduction

In recent years, corporate governance has gained significant attention as an essential mechanism for ensuring effective management and safeguarding shareholders' interests. Within the realm of corporate governance, the composition and structure of the board of directors play a critical role in influencing firm value. It is charged with hiring, controlling, monitoring, evaluating, rewarding, replacing and advising management to ensure that all managerial decisions maximize shareholder value. (Haldar, Shah & Rao, 2014, Njaya & Chimbadzwa, 2015). The responsibility of the board of directors is formulated through many indicators, such as board size, board independence, board diversity, board equity, board skills, board meetings, board compensation and board sub-committees (Tanmanee, Prasertsri & Boonyanet, 2015). The importance of board of directors as an important mechanism is evidenced by the increased interest and deliberations by various scholarly articles (e.g., Carter, Simkins & Simpson, 2003; Amedro & Forai, 2004; Erickson, Park, Reising & Shin, 2005; Muhammad 2009; Ahern & Dittmar; 2011; Dunstan, Keeper, Truong & van Zijl, 2011; Black & Kim, 2012; Haldar, et al., 2014; Hamidu & Modibbo, 2015) corporate sector and policy makers. Additionally, capital markets regulators and other stakeholders globally, have continued putting efforts to boost corporate governance practices in relation to firms' boards.

The importance of board structure as a mechanism that enhances firm value is further reinforced by the increased documented research in this area (Susanti & Nadar, 2016; M'ithiria, Musyoki & Shawa, 2017; Mishra & Kapil, 2018; Musa, Kabir, Aripin, & Al-Dhamari, 2019; Al Shaer, Kuzey, Uyar, & Karaman, 2023; Usman & Yahaya, 2023). Even though, there are several ongoing debates on the relationship between board structure and firm value effect, there has been no conclusive evidence from literature to date (Cunat, Gine & Guadalupe, 2012; M'ithiria, Musyoki & Shawa, 2021). This is because, while some studies document a positive significant relationship (Carter, et al. 2003; Black et al., 2006; Abbasi et al, 2012; Black & Kim, 2012; Haldar, et al., 2014; Tanmanee, et al., 2015; Kabir, Aripin, & Al-Dhamari, 2019; others reported a significant negative relationship between the board of directors and firm value (Amedro & Forai, 2004; Black, De Carvalho & Gorga, 2009, Ahern & Dittmar, 2011; Usman & Yahaya, 2023), while still, some other studies found mixed evidence (Mak & Kusadi, 2005; Muhammad 2009; Dunstan et al, 2011; Rouf 2011; Davila 2014; Al Shaer, 2023).

Moreover, prevailing evidence on board structure and firm value tend to be concentrated in developed economies like Sweden (Carter et al, 2003 in US; Amedro & Forai, 2004); Canada (Erickson et al, 2004; Gupta et al, 2009); Korea (Black et al, 2006; Black & Kim 2012); Norway (Ahern & Dittmar, 2011;); New Zeakand (Dunstan, et al, 2011); Italy (Bubbico et al 2012) and emerging economies like Turkey (Aghabeigi & Ondes, 2015); Indonesia (Susanti & Nidar, 2016); Brazil (Black, et al., 2009); Romania (Ghergina, 2015); India (Balasumbramanian, et al, 2010; Haldar et al, 2014). While research in developing countries such as Bangladesh (Rouf, 2011); Kenya (M'ithria, et al, 2017); and Nigeria (Muhammad 2009, Musa et al, 2019; Usman & Yahaya, 2023) are limited. The current study hopes to address this gap.

Also, a lot of pressure is mounted on boards of directors to attain many enterprise goals which will foster principles that will provide long-term value creation, focus on sustainability issues affecting the firm's long-term strategy, result in an improved diversity of the board and management team, enhance oversight of risk, and strengthen engagement efforts with stakeholders.

As boards tackle these challenges, a framework that will optimize board structure to enhance value creation for the firm will aid the functioning of boards and management, as well as strengthen the effectiveness of the board's procedures and practices. However, given the importance of optimizing board structure to achieve an enhanced firm value, there is limited guidance available in both scholarly literature and from regulatory bodies regarding the ideal model framework to be employed. This motivated the current study to provide a conceptual framework to achieve this important objective.

It is worth knowing that the study utilized a systematic literature-review based methodology and has established that there are a number of notable contributions on board structure and firm value such as the studies of Amedro and Forai (2004), Javed and Iqbal (2007), Muhammad (2009), De Toledo (2010), (2012), Black and Kim (2012), El-Faitouri (2012), Davila (2014), Tanmanee et al. (2015), Gherghina (2015), Hamidu and Modibbo (2015), Hamza and Mselmi (2018); Mishra and Kapil (2018); Salem, Metawe, Youssef and Mohammed (2019); Kabir, et al (2019); Ebimobowei (2022); Al-Shaer, Kuzey, Uyar and Karaman (2023); Usman and Yahaya (2023).

However, even though the above cited studies utilized different methodologies such as ordinary least squares (Ahmad & Forai, 2014; Black, et al 2009; Rouf 2011; Ghergina, 2015; Tanmanee et al, 2015; Musa, et al, 2019; Al Shaer, et al, 2023); generalized least squares (Erickson, et al, 2003; Mak & Kusadi, 2005; Ahern & Dittmar, 2011; Bubbico, et al, 2012; Aghabeigi & Ondes, 2015) and advanced techniques such as GMM - generalized method of moments (Javed & Iqbal, 2007); 2SLS (Carter, et al, 2003; Black & Kim, 2012) and 3SLS (De Toledo, 2010), there seems to be mixed results. Thus, the inconclusive evidence from existing literature provides a need to conduct more studies on board structure and firm value association so as to provide direction for further research. Accordingly, this paper seeks to provide more insights on board structure and its effect on firm value.

Similarly, there is an observable dearth of literature on optimizing board structure to enhance firm value. This study, therefore seeks to complement the existing literature on the subject matter by reviewing empirical studies on board structure and firm value to develop a conceptual framework for optimizing board structure to enhance firm value. To the best of the researchers' knowledge, this is the first attempt in providing a conceptual framework for optimizing board structure to enhance firm value in Nigeria and elsewhere.

2. Literature Review

2.1 Theoretical Review

Studies on the impact of board structure attributes on firm value, have used three theories in explaining the relationship. These are the agency, resource dependence and signaling theories.

Agency theory stresses that board characteristics are essential to manage agency conflict and that it is not just about a board exercising governance, but that specific board attributes such as board size and independence, are necessary to exercise governance (Ogbechie, 2012). For instance, agency theory argues that a substantial increase in board size board could lead to a deceleration in the decision-making process and an increase in costs. Furthermore, owing to the conflict of interest between agents and principals, the presence of independent directors may also act to reduce the agency problem (Fama, 1980; and El-Faitouri, 2012).

The second is the resource dependence theory, which suggests that the board of directors, for instance, is an essential link between the firm and the financial and non-financial resources that are crucial for the firm's growth (Pearce & Zahra, 1992). As such, the board of directors not only performs a monitoring role, but also provides necessary critical resources, such as business contacts and contracts, knowledge, experience and expertise (Nicholson & Kiel, 2007; Chen, 2011). This can maximize the firm value (Pearce & Zahra, 1992; Bathula, 2008). Similarly, the board of directors has the capability to represent the interests of different stakeholders, such as local communities, government, employees, suppliers, customers, creditors, regulators and policy makers (Nicholson & Kiel, 2007). Thus, the board of directors can help the firm to achieve competitive advantage by serving as a direct link between the firm and the environment within which it operates (Albassam, 2014).

The third is the signaling theory, which explains firm's incentive to voluntarily report information to capital markets even though there is no mandate from regulatory agencies (Wolk, Tearney & Dodd, 2001). examined the relationship between board structure and IPO under-pricing. Consistent with signaling theory, the study of Certo, Daily and Dalton (2001) on a sample of IPOs in 1990s, found a negative association of board size and board reputation with IPO under-pricing, while an opposite association was found for board composition and board leadership structure with IPO underpricing.

2.2 Conceptual Framework

From figure 1, the conceptual framework demonstrates the relationship between the dimension of the independent variable and the dependent variable.

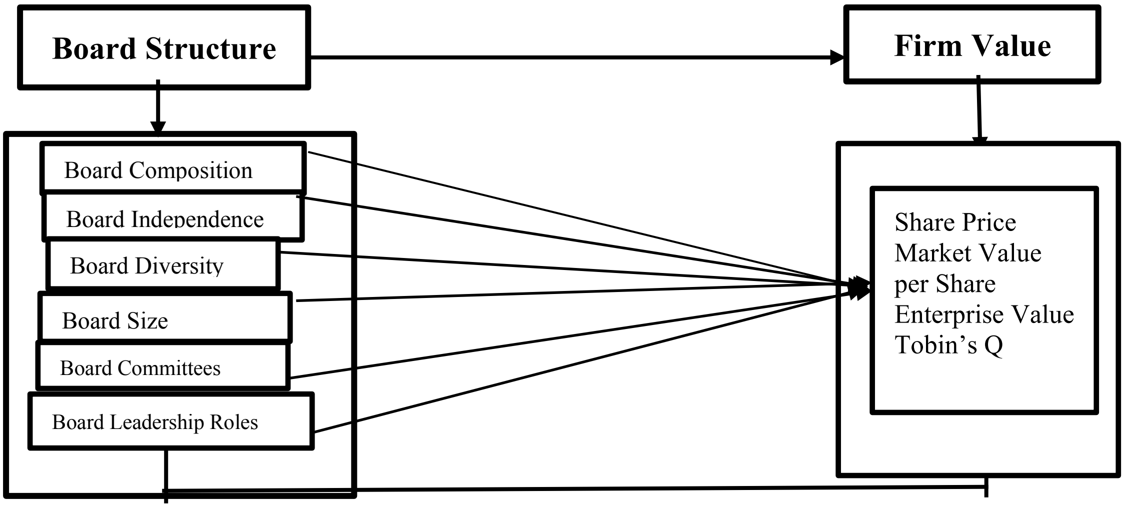

Figure 1: Conceptual Framework showing the relationship between Board Structure and Firm Value

2.2.1 Board Structure

According to Chen and Jaggi (2001), board structure refers to the characteristics, composition and organizational arrangements of the board of directors, which includes amongst others; its size, committee structure, diversity, independence, and the responsibilities and roles and of its members. Board structure therefore encompasses both the formal and informal mechanisms through which the board carries out its advisory functions, responsibilities and decision-making within an organization. There are several proxies used in the literature to measure board structure as variables for both conceptual and empirical review. These representations are further expounded on.

Board Composition

Board composition refers to the overall makeup of a company's board of directors, including the number of directors, their backgrounds, skills, and experience. The composition of the board should reflect the strategic objectives and unique characteristics of the firm, taking into account the industry, company size, and growth stage (Hermalin & Weisbach, 2012). Studies have shown that boards with a diverse mix of directors possessing relevant industry knowledge and experience tend to enhance firm performance and value (Adams & Ferreira, 2009). Additionally, the presence of independent outside directors and a balanced mix of executive and non-executive directors has been associated with higher firm value (Daily, Dalton & Cannella, 2003).

Board Independence

Board independence refers to the extent to which a board of directors is free from conflicts of interest and can make decisions objectively in the best interest of the company and its shareholders.

Corporate bodies need a board of directors with tactical vision in addition to effective monitoring. Board independence has been a subject of extensive empirical research. Evidence indicates that higher levels of board independence are generally associated with improved firm value. Independent directors are expected to provide objective oversight and effective monitoring of management, leading to better decision-making and increased shareholder value (Yermack, 1996).

In addition, outside directors with executive expertise are critical for shareholder value development (Pregio de la Cruz, Lizano & Marid, 2014).

Board Diversity

Board diversity encompasses having a variety of directors who bring different backgrounds, experiences, perspectives, and demographics to the boardroom. It includes diversity in terms of gender, ethnicity, age, skills, and industry knowledge. A diverse board promotes better decision-making, innovation, and the ability to understand and cater to a broader range of stakeholders' interests (Erhardt, Webel & Shrader, 2003). Increasingly, empirical evidence suggests that board diversity can positively influence firm value.

Board Size

Board size refers to the number of directors that make up a company's board. The appropriate board size depends on various factors, such as the company's size, complexity, and the industry it operates in. Board size comprises the total number of directors on the board, i.e., non-executive directors plus executive directors (Alwshah, 2009; Dunstan, Keeper, Truoug, & Zij, 2011; El-Faitouri, 2012).

Board Committees

Board committees are smaller groups of directors assigned specific responsibilities to address specific areas of governance and oversight. Typical board committees include the audit committee, compensation committee, and nominating/governance committee. The committee structure should align with the company's strategic objectives and unique characteristics, ensuring effective oversight and expertise in key areas (Carpenter, Geletkanycz, & Sanders, 2004). Empirical studies have shown that effective functioning of these committees positively impacts firm value (Brickley, Smith Jr, & Zimmerman, 2002; Ng, Chong & Ismail, 2013).

Board Leadership Roles

Board leadership roles refer to the positions and responsibilities within the board, including the roles of the chairman, CEO, lead independent director, and committee chairs. The distribution of leadership roles should be designed to promote effective decision-making, accountability, and the appropriate balance of power between management and the board (Filatotchev, Jackson & Nakajima, 2013).

2.2.2 Firm Value

Jensen (2001) states that firm value denotes the financial worth of a firm and is measured by the market value of its equity. It represents the expectations of company investors of the firm's future cash flows, growth potential, profitability and risk. Several factors such as corporate governance practices, competitive positioning, financial performance and overall market conditions can influence firm value. Similarly, Damodaran (2007) views firm value as a cumulative measure which represents the economic value generated by a corporation's assets, investments and operations. The concept of firm value can be seen as the current value of projected future cash flows discounted at an appropriate rate. Firm value therefore, is a reflection of the market assessment of a firm's ability to create long-term shareholder wealth, engender sustainable profits and manage risks. Measures of firm value as discerned from the review of literature include, share price, market value per share, enterprise value and Tobin's q.

2.3 Empirical Review on Board Structure Attributes and Firm Value

The effect of board structure on firm value is a central issue to the corporate organizations and researchers. There are a number of studies on board structure and firm value at different times in developed, as well as, developing countries, and most of which are well documented in the area of accounting and finance.

From the empirical review of relevant literature, it is evident that the findings regarding the effect of board structure on firm value have generated varied results ranging from those establishing a significant positive relationship, (Carter, D'Souza, Simkins & Simpson, 2003; Javed & Iqbal, 2007; Black, Yang & Kim, 2006;

Abbasi, Kalantari & Abbasi, 2012; Bubbico et. al., 2012; Black & Kim, 2012; Aghabeigi & Ondes, 2015; Kabir, et. al., 2019); to those reporting a significant negative relationship (Amedro & Forai, 2004; Erickson, Park, Reising, & Shin, 2005; Black, De Carvalho, & Gorga, 2009; Ahern & Dittmar, 2011; Hamidu & Modibbo, 2015). Others however, report not significant results (Gupta, Kennedy & Weaver, 2009; Balasrumbramanian et. al., 2010; Ficici & Aybar, 2012; Gherghina, 2015); with some reporting mixed evidence (Mak & Kusadi, 2005; Muhammad 2009; De-Toledo 2010; Dunstan, Keeper, Truong & Zijl, 2011; Rouf 2011; Dewila 2014; Susanti & Nidar, 2016; Al-Shaer et. al., 2023).

It was also observed from the review of literature, that despite the fact that current studies introduced mediating factors or used board structure as the mediating variable (Susanti & Nidar, 2016; M'ithria et al., 2017; Kabir et al., 2019; Al Shaer, et al., 2023), the results obtained were still inconsistent. In addition to the contradictory findings, documented evidence tends to focus on corporate governance as a whole (Javed & Iqbal, 2007; Black et al, 2006, 2009, Gupta et al, 2009, Ficici & Aybar, 2012; Davila 2014; M'ithria et al, 2017; Kabir et al, 2019, AlShaer et al, 2023), with few studies focusing on the overall board structure (Erickson et al, 2005; Muhammad 2009; Dunstan, et al 2011; Usman & Yahaya, 2023). Also, the review shows that most of the past studies done in this area have focused on the developed and emerging economies while research in developing countries still remain limited. Furthermore, the available literature on developing economies, indicate that researches focus on specific board structure components in contrast with the case of developed economies where the focus is on the overall board structure.

3.Methodology

This study adopts a systematic literature-based methodology considering that it reviews related empirical literature on the subject matter, synthesizing and comparing the findings with the aim of arriving at a conclusion. Snyder (2019) defines a systematic literature review as a research method and process for identifying and critically appraising relevant research as well as for collecting and analyzing ideas from the findings of the reviewed research. The proposed framework for optimizing board structure and the conclusion and recommendations for further study are therefore drawn and proffered based on the findings of the literature reviewed.

4. Framework for Optimized Board Structure and Enhanced Firm Value

From the contradictory findings of empirical studies in Table 1, the varied results could be attributed to institutional differences among countries, the different measurements of the variables used, the period of time covered by the studies, as well as the different techniques of analysis employed. Although the results of the studies are mixed, it can be discerned that board structure is an important factor in determining the firm value. As such, the CEOs, management, stakeholders, and regulatory bodies need to strategize inwards by incorporating certain mechanisms and strategies that will facilitate in optimizing board structure for enhancement of firm value.

As opined by Nor and Zawawi (2016) optimizing board structure suggests a firm can function efficiently, attain better firm performance and ultimately obtain an enhanced firm value, given its board composition. Developing a framework to optimize board structure for enhanced firm value is a strategic decision that many organizations undertake to improve their overall performance and maximize shareholder value. The rationale behind such a framework is rooted in several key factors that highlight the importance of an effective board structure. These factors include the crucial role board of directors play in corporate governance, ensuring that the organization is managed in the best interests of its shareholders and stakeholders. An optimized board structure strengthens corporate governance practices, which in turn promotes transparency, accountability, and ethical behavior.

4.1 Mechanisms for Optimal Board Structure

Optimizing board structure requires certain mechanisms to achieve an enhanced firm value. Even though Nor and Zawawi (2016) posit that determining an optimal board structure for superior firm performance might be elusive, a lot of scholarly articles Nicholson, and Kiel (2004); Ashiru, Nakpodia, and Adegbite (2019); Harvard Law School Forum on Corporate Governance (2016); Martin and Herero (2018), have postulated various internal strategies that should be considered by organizations in optimizing the structure of their boards in order to have a superior firm performance and ultimately an enhanced firm value. The analysis of mediating factors that translate an optimized board into enhanced firm value involves examining the mechanisms and variables that link the effectiveness of a company's board of directors to its financial performance and overall value. Several key factors have been identified in research as potential mediators in this relationship. Here is an overview of relevant mechanisms that explore these factors.

4.1.1 Board Processes and Dynamics

Effective board processes and dynamics play a crucial role in determining a board's ability to create value. Factors such as board leadership, board committees, CEO-chair duality, board meetings, and board communication have been examined as potential mediators. Research suggests that active participation, constructive debates, effective decision-making, and open communication channels between the board and management positively influence firm performance and value (Wetphal & Zajac, 1998; Gabrielsson, Huse, & Minichilli, 2007).

4.1.2 Board Monitoring and Control

Effective monitoring and control mechanisms are vital for translating an optimized board into enhanced firm value. Board monitoring involves overseeing management actions, monitoring financial performance, and ensuring compliance with regulations. Factors such as board independence, the presence of audit and compensation committees, and CEO monitoring have been explored as potential mediators. Research suggests that strong monitoring mechanisms positively impact firm value by reducing agency problems and enhancing accountability (Fama & Jensen, 1983; Hambrick, Misangyi, & Park, 2015).

4.1.3 Strategic Involvement and Resource Provision

Boards that actively engage in strategic decision-making and provide resources and expertise to the organization can significantly contribute to firm value. Factors such as strategic involvement, knowledge diversity, and resource allocation have been examined as mediators in this context. Research suggests that boards that provide strategic guidance and facilitate resource acquisition and allocation can positively influence firm performance and value (Pearce & Zahra, 1992; Barroso-Castro, Villegas-Perinan, & Dominguez, 2017).

Similarly, an effective board comprises directors with diverse expertise and experience relevant to the company's industry, operations, and strategic direction. A well-designed framework helps identify the necessary skill sets required on the board, ensuring a collective wealth of knowledge that can provide valuable insights and guidance to the management team. The following mechanisms are proposed based on extensive review of literature in developing the framework.

4.2 Strategies for Optimal Board Structure

An optimized board structure impacts firm value through its influence on decision making, strategic formulation, monitoring and accountability, CEO selection and compensation, risk management, stakeholder alignment, external relations, succession planning, and leadership development. Applying these proposed strategies, can strengthen organization's boards to effectively drive value creation and sustainable growth.

4.2.1 Strategic Decision Making

Boards are responsible for making critical strategic decisions that drive the company's long-term growth and success. By optimizing board structure, organizations can enhance the quality of decision making through a balanced representation of independent directors, executives, and industry experts. The composition and structure of the board significantly affects decision-making processes and strategic formulation. A diverse board with directors possessing relevant expertise and experience can bring fresh perspectives, challenge management assumptions, and contribute to more informed and effective decision making. This, in turn, leads to better strategic choices, improved resource allocation, and ultimately enhances firm value (Wang, Xie & Min, 2015; Syed, Abdul & Julizaerma, 2016; Martin and Herrero, 2018; Soltwisch, Ma, & Syed, 2022)

4.2.2 Risk Management and Oversight

Effective risk oversight is a fundamental responsibility of the board. An optimized board structure facilitates the establishment of robust risk management practices by assigning clear roles and responsibilities, establishing specialized committees, and fostering a culture of risk awareness throughout the organization. This enables proactive identification, assessment, and mitigation of risks, safeguarding the firm's value (Deloitte, 2018; Schuermann, & Pellerin, 2021).

4.2.3 Succession Planning and Leadership Development

Board structure influences the effectiveness of succession planning and leadership development processes within an organization. A well-designed board ensures that a robust succession plan is in place, talent pipelines are developed, and leadership capabilities are nurtured. Smooth leadership transitions and a strong bench of qualified executives contribute to long-term stability, continuity, and firm value. Boards are responsible for selecting and overseeing the performance of the CEO and other top executives. A well-designed framework ensures a structured and transparent process for CEO succession planning, focusing on leadership development and talent pipeline. This reduces the risk of leadership gaps and facilitates seamless transitions, thus enhancing long-term firm value (Routch, Donahan & Doherty, 2018; Moats & DeNichola, 2021).

4.2.4 External Relations and Investor Confidence

The composition of the board, particularly the presence of independent directors and industry experts, can positively influence external relations and investor confidence. An independent board enhances transparency, reduces conflicts of interest, and signals good governance practices to investors. This can lead to increased investor confidence, improved access to capital, and potentially higher firm valuation in capital markets (Martin and Herrero, 2018; McLeod, 2021).

4.2.5 Regulatory Compliance

Regulatory bodies often mandate certain board composition requirements for companies operating in specific industries or jurisdictions. Developing a framework to optimize board structure ensures compliance with relevant regulations, avoiding penalties, reputational damage, and potential legal issues (Delloite, 2018).

An integrated approach to Optimal Board Structure

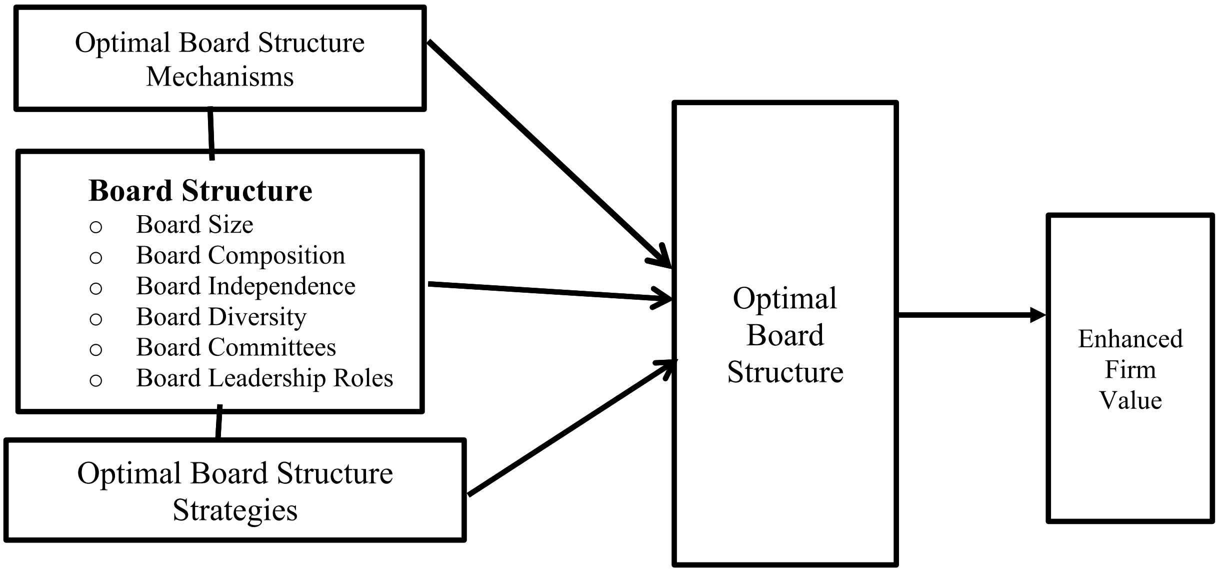

Figure 2: Conceptual framework for Optimizing Board Structure for enhanced Firm Value

5. Conclusion

The rationale for developing a framework to optimize board structure for enhanced firm value lies in the potential to strengthen corporate governance, leverage diverse expertise, improve strategic decision making, manage risks effectively, plan for succession, boost investor confidence, and comply with regulatory requirements. By focusing on these aspects, organizations can foster a more effective and value-driven board that contributes to the long-term success of the firm. Additionally, by exploring the conceptual framework and its various components, this paper aims to contribute to the existing literature on board structure and firm value through the provision of a roadmap for organizations to strategically enhance their board structure and ultimately maximize firm value. Lastly, it is hoped that the application of this model will assist Nigerian firms in attaining an optimal board structure that will have a positive impact on firm value.

6. Limitations and Suggestion for Further Studies

The paper was conducted using a literature-review based methodology which formed the basis of the findings and conclusion of the study. The proposed conceptual framework of the study has consequently not been empirically tested to determine whether an improved statistical significance will be established. Further studies can be conducted using empirical methods of analysis which will possibly produce a more reliable result that will provide a roadmap for policy making.

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