

The Effect of the Board of Directors' Characteristics on Company Value

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ABSTRACT

This study aims to analyze the influence of the characteristics of the board of directors on company value. The characteristics of the board of directors are measured by size, age, and activities on company values. The samples of this research were taken randomly from 266 companies listed in the Indonesia Stock Exchange during 2011-2017. The results of this study indicate that the size of board of directors has a negative and significant effect on company value. However, age and activities of the board of directors and company growth do not have a significant effect on company value. Meanwhile, company leverage has a positive and significant effect on company value.

Keywords: *Company value, size, age, activities, board of directors*

1. INTRODUCTION

Indonesia is one among emerging countries in the world. Emerging country has low quality of legal environment and weak protection for investor (La Porta et al., 1998), poor corporate governance system (Joh, 2003). The characteristic of board of directors is one among the ways to create better corporate governance practice. According to Berezinets, Ilina, and Cherkasskaya (2017), the effect of board of directors characteristics on company value is one among the issues that are still in debate.

Several prior researches most focused on board of directors characteristics in Anglo-Saxon system (Baysinger and Butler, 1985; Nelson, 2005; Assenga, Aly, and Hussainey, 2018). Meanwhile, limited attention of researchers explore the effect of board of directors in Continental European system (e.g., Melmusi, Ilona, Elfiswandi, and Kumiawan, 2019).

Board of directors produces a crucial information for practices, strategies, and other decision-making in order to solve the company's problems (Fernandez and Thams, 2018) as the backbone for better corporate governance (Bozec and Dia, 2017) and important part of internal mechanism, when external mechanism is not effective (Kamardin and Haron, 2011).

The current study contributes to the literature in term of theoretical and practical area. From theoretical area, this study examines the effect of board of directors characteristics and company value in countries that adopt Continental European system. This system has two separate board, namely board of commissioners (monitor and control the strategy taken by board of directors) and board of directors (manage the company operation). Thus, this study offers the knowledge of how board of directors characteristic could influence company value.

In general, board of commissioners is chosen by general meeting of shareholders and board of directors is selected by board of commissioners in Continental European system. However, Indonesia has modified the system while board of commissioners and board of directors are voted by general meeting of shareholders. This practical phenomenon will impact the power of board of commissioners in monitoring and controlling the action taken by board of directors. Thus, the characteristics of board of directors could improve the effectiveness of board of directors in managing the company's operational and finally enhancing the company value.

The remainder part of this study is prepared as follows. Section two explores related literature and hypothesis development of board of directors characteristics and company value. Section three provides research design. It continues to explain the findings and discussion of this study. Finally, it reports about the conclusion and recommendation of this study.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Agency theory claims that separation of directors and owners create conflict of interest among them (Jensen and Meckling, 1976). Board of directors characteristic could reduce the agency cost and enhance the shareholders' wealth.

2.1. Size of Board of Directors

Size of board of directors is the number of board of directors member. Larger number of board of directors is likely less effective to increase company value (Kumar and Singh, 2013), create greater conflict among board members (Goodstein, Gautam, and Boeker, 1994), and increase cost associated to board of directors (Merendino and Melville,

2019). However, other studies believe that increasing number of board member creates the ability to solve the company's problem (Haleblian and Fininkelstein, 1993) and to create better market value (Larmou and Vafeas, 2010). Jensen (1993) claims that the ideal number of board members are not more than seven figures.

Kumar and Singh (2013) investigated the effect of board of directors size and company value among 176 selected companies listed in India. They found that the size of board of directors has negative impact on company value. Nuryanah and Islam (2011) found that the size of board of directors has a positive and significant impact on company value. Adeabah, Gyeke-dako, and Andoh (2019) examine 21 banking companies for 2009-2017 periods. They found that the number of board members could increase bank efficiency.

H1 : The size of board of directors has relationship with company value.

2.2. Age of Board of Directors

Age of board of directors gives impact on decision making. Younger directors tend to choose risky strategies in order to enhance future company performance (McClelland, Barker, and Oh, 2012), while older directors has more experience, economic resources, and wisdom (Kang, Cheng, and Gray, 2007).

Previous studies that focused on age of board of directors and company value shows mix results. Kagzi and Guha (2018) found that age of board of directors has positive and significant impact on company value. Alqatamin, Aribi, and Arun (2017) examined the relationship between directors' age for non-family versus family companies and earning management. They found that directors' age has no relationship with earning management. McClelland et al. (2012) found that directors' age has little impact on future company performance. In addition, the effect of directors' age has received slow attention form researchers (Halioui, Neifar, and Abdelaziz, 2016; Kagzi and Guha, 2018).

H2 : Age of board of directors has relationship with company value.

2.3. Activities of Board of Directors

Activities of board of directors means that multiple directorships are held by board members. Busy board create absence from meeting (Li and Ang, 2000), destroy the capability of board of directors to conduct their responsibility effectively (Kavitha, Nandagopal, and Uma, 2019), and reduce company performance (Haniffa and Hudaib, 2006). However, busy board of directors create better expertise of board in managing the company's operation (Jiraporn, Singh, and Lee, 2009).

Prior study conducted by Chen, Gray, and Nowland (2013) found that busy board of directors has negative and significant impact on company value. Therefore, Field, Lowry, and Mkrtchyan (2013) found a positive and significant relationship between busy board of directors and company value. Kavitha et al. (2019) investigated the effect of busy board of directors on discretionary disclosures

among 500 companies listed in India. They found that busy board of directors has negative impact on discretionary disclosures.

H3 : Busy board of directors has relationship with company value.

3. RESEARCH METHOD

The sample of this paper comprised of 266 companies listed in Indonesia during 2011-2017 periods. The dependent variable of this research is company value. To assess the company value, this study has employed Tobin's Q. According to Kagzi and Guha, (2018), Tobin's Q is an expected value of future cash flow from the market value of company's assets. This study follows the prior work of Klapper and Love (2004) to measure Tobin's Q.

The size of board of directors is calculated with the number of board of directors members (Hoseini, Gerayli, and Valiyan, 2019). The age of board of directors is measured by the difference among board of directors' date of birth and the year of this study (Alqatamin et al., 2017). The activities of board of directors is proxied as the proportion of multiple appointments of board of directors in other companies (Virk, 2017).

Company growth and company leverage are control variables of the current study. Company growth is measured by the sales of this year less the sales of last year and then divided by the sales of last year (Mak and Kusnadi, 2005). Company leverage is a leverage ratio, which is proxied by using total debt divided by total assets (Alqatamin et al., 2017). Multivariate regression analysis is applied to analyze the data (Gujarati, 1995) and the mathematical model is demonstrated below.

$$TOQ_{it} = \alpha + \beta_1 SBOD_{it} + \beta_2 ABOD_{it} + \beta_3 BBOD_{it} + \beta_4 CG_{it} + \beta_5 CL_{it} + e \quad (1)$$

TOQ = Tobin's Q

SBOD = Size of board of directors

ABOD = Age of board of directors

BBOD = Activities of board of directors

CG = Company Growth

CL = Company Leverage

4. RESULT AND DISCUSSION

The analysis of this study is started by conducting the classical-assumption test. Normality, multicollinearity, and heteroskedasticity test have been conducted. The result shows that the model is free from classical-assumption problem. As can be seen in Table 1, the descriptive statistics results present that the average and median of Tobin's Q is 0.91 (0.79), while the minimum and maximum value of Tobin's Q is 0.05 (2.55).

Board of directors variables shown as SBOD has a mean 4.56 with median 4. The average of ABOD is 52.01 and the median is around 50.5 years old. The mean (median) value of BBOD is around 0.27 (0.00). The average (median) of company growth and company leverage are around 0.31

(0.29) and 0.57 (0.48). The result of descriptive statistics has been showed in Table 1 as follow.

Table 1 Descriptive Statistics

	Min	Max	Median	Mean	Std. Dev
TOQ	0.05	2.55	0.79	0.91	0.52
SBOD	2.00	13.00	4.00	4.56	2.35
ABOD	29.00	72.00	50.5	52.01	8.45
BBOD	0.00	1.00	0.00	0.27	0.25
CG	-8.56	76.12	0.29	0.31	2.79
CL	-2.89	10.79	0.48	0.57	0.49

Notes: TOQ (Tobin's Q), SBOD (Size of board of directors), ABOD (Age of board of directors), BBOD (Activities of board of directors), CG (Company growth), CL (Company leverage).

In examining the effect of board of directors' characteristic on company value, this paper employes multivariate regression analysis. This study conducts the fixed effects panel data regression analysis to investigate the effect of board of directors' characteristic on company value.

Table 2 shows the fixed regression results of this study. SBOD has negative and significant relationship with company value. It means that small size of board members may enhance company value due to small size of board members is more effective in decision making. This finding is in the opposite with that from previous study (Adeabah et al., 2019). They found that larger number of board members could increase bank efficiency.

The next independent variable is ABOD. ABOD has insignificant association with company value. This result appears to be consistent with Alqatamin et al. (2017) and Arun (2017), which stated that there is insignificant relationship between BBOD and company value. Thus, this result does not support the related hypothesis and the study of (Field et al., 2013). They found that BBOD has positive and significant association with company value. The control variables shows mix results.

Table 2 Fixed Effect of Regression Result

	Coef	Std. Error	t-Stat	Prob.
C	0.80	0.13	6.06	0.00
SBOD	-0.02	0.00	-3.12	0.00*
ABOD	0.00	0.00	0.84	0.40
BBOD	0.02	0.05	0.39	0.69
CG	0.00	0.00	0.15	0.87
CL	0.17	0.02	8.26	0.00*
R ²	0.74			
Adj. R ²	0.70			
F Value	0.00			

Notes: * indicates significant at 1%, SBOD (Size of board of directors), ABOD (Age of board of directors), BBOD (Activities of board of directors), CG (Company growth), CL (Company leverage).

Company growth (CG) has no relationship with company value. However, company leverage (CL) has positive and

significant effect on company value. It indicates that debt holders are more effective in monitoring the company action in order to enhance the stakeholders wealth. This finding is inconsistent with (Grove, Patelli, Victoravich, and Xu, 2011). Grove et al. (2011) found that company leverage has negative impact on company value.

5. CONCLUSIONS

The result presented in this study shows that board of directors characteristics as measured by board size significantly influences company value. However, other variables of board characteristics, that are age and activities of board of directors have no effect on improving company value. This paper provides the highlight to agency theory whereas large size of board members can create the problems of communication and decision making.

The negative effect of board size on company value implies that company value would increase if there is no communication and decision making problem. this study has several limitations, such as small sample and one perspective. Future investigation should be focused on more samples and various perspectives.

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