

The Influence of Board Independence on Ability to Operate and Capital Structure through Corporate Governance Disclosure of Companies Listed on the Stock Exchange of Thailand

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Abstract

The objective of this study is to investigate the influence of board structure on corporate governance, profitability and capital structure of 254 listed companies in the stock exchange of Thailand. By analyzing data based on Multiple Indicators and Multiple Causes (MIMIC) Model. The findings reveal a harmony between hypothetical assumption and empirical analysis with the results of statistical tests. It can be concluded that the research, board structure of independent director (BSOI) and director's relative (DTRT) has a positive influence on corporate governance disclosure (CGRD) at coefficient value of 0.26 with a significance level of .05 and 0.27 with a significance level of .01 . Also, corporate governance disclosure (CGRD) positively effect on profitability (PFBR) and capital structure (CPTS) at coefficient values of 0.33 with a significance level of .05 and 0.20 with a significance level of .01 respectively.

Keywords: Board, Capital Structure, CG

Introduction

The problem about representatives is considered an important problem in Thailand that triggers from seizing optimum benefits for oneself between major shareholders and minor shareholders including management structure without board independence. Moreover, it has been found that most companies are growing from family-owned businesses which management structure and the power to control of shareholder groups are considered important factors affecting management model. Meanwhile, it has been found that the movement of money from one company to another one can be easily done when receiving traffic of influence from acquainted management executives so as to expect benefits for their families and relatives. The research study of Connelly et al. (2012) found that companies run by family had firm performance lower than companies managed by professional executives hired from outside because the quality of company information disclosure was low and executives gave less importance to the information disclosure since they could communicate to one another from various channels. The movement of company resources by having traffic of influence from the group of executives or any group of persons who had influence on companies with regards to creative accounting or even presentation of financial reports that did not reflect a true and fair view of an entity's performance, position and cash flows had effect on investors to make mistakes in decision-making (Mohammad, 2008: 285). Company management, management structure, and board structure are considered factors that have impact on company profitability.

The mentioned problems continually reflect severity. Conflict of interest and company management without business ethics caused by imbalance between management and ownership (Bonna, 2012) is deemed unethical behavior; the business expected only optimum

benefits and searched for methods to bring all interests to oneself and their relatives, while the law rules and regulations and professional standards are considered as obstacles for work implementation. As a result, the Stock Exchange of Thailand has applied the concept of corporate governance as a tool to control and inspect the operation and implementation of management executive groups according to the regulations that the Stock Exchange of Thailand has designed. Companies shall carefully make the entire operation and their execution to be acceptable by setting transparency policies and information disclosure appropriately and correctly (Cheung et al., 2007: 94; Gleason & Mills, 2008; Dhaliwal et al., 2008: 62; Ammann et al., 2011: 41; Lanis & Richardson, 2011: 61). Most companies listed on the Stock Exchange of Thailand have corporate ownership structure as concentrated ownership; management in family-owned firms with the power to control. At present companies give importance to corporate governance so as to maintain good reputation of companies and continually build trust and credibility with customers for organizations' sustainability.

The study in the past found that company management with corporate governance had influence on firm performance. Good corporate governance of companies with a corporate governance high score resulted in high firm performance (Cheung et al., 2007: 94; Ammann et al., 2011: 41). However, some research studies in the past found that corporate governance did not have influence on firm performance and the direction of the influence could not be concluded in essential elements (Price et al., 2011: 82; Connelly et al., 2012: 1734). Good corporate governance is an important thing and major factor that results in company's growth for establishing long-term survival of company. Many companies at present use corporate governance principles as a tool to reduce conflict of interest. Good corporate governance can set the tone of good relationship between shareholders and collaboration within organizations. As a result, management is carried out with correct principles and true information resulting in chances for investing. Furthermore, it was found that owner structure, financial risk (Leverage), committee, and executive compensation) were related with a negative significance to company's value (Bonna, 2012). Meanwhile, Pham, Suchard & Zein (2011) studied the relationship between good corporate governance and firm performance of companies in Australia but did not find the relationship between company operational performance, considering from Tobin's Q ratio and economic value added (EVA), and good corporate governance of companies. The study of Beiner, Drobetz, Schmid & Zimmermann (2004) found that proportion of shareholding and independence of outside board of directors had influence on company's value in a positive direction and independence of outside board of directors (Helland & Sykuta, 2005: 155; Lee & Carlson, 2007: 31) and independence of inside board of directors (Mohammad, 2008: 282; Kajola, 2008: 14) had influence on good corporate governance and increased operational performance and profitability with a significant element.

Consequently, the researcher realizes the mentioned importance that can reflect the importance of good corporate governance when company executives have independence and are not overpowered by any of executive groups. By the way, good corporate governance of executive groups can extremely benefit those who would like to invest with companies that lead to company sustainability resulting in economic development of the country in a stable and sustainable way.

Research Objectives

The objective of this research aims to analyze the causal relationship of the influence of board structure of independent director and director's relative on profitability and capital structure through corporate governance of companies listed on the Stock Exchange of Thailand.

Literature Review

The scope of the research embraces the following 3 theories:

Stakeholder Theory: it is a theory continuously developed since 1970 (Freeman, 1984). The theory focuses on organizational policies that affect stakeholders who are involved with organizations by considering Need, Interest, and Effect caused by policies and firm performance of the organizations. The way that organizations can survive or collapse depends on righteousness between stakeholders and organizations (McWilliams & Siegel, 2001). The stakeholder theory has the point that board independence has influence on corporate governance (Helland & Sykuta, 2005: 155; Lee & Carlson, 2007: 31) and independence of inside board of directors (Mohammad, 2008: 282; Kajola, 2008: 14) has influence on corporate governance and increases ability to operate and profitability significantly.

Corporate governance has influence on firm performance. It is deemed as company management that relies on corporate governance of companies listed on the Stock Exchange that has effect on firm performance through scoring assessment as an indicator. It has been found that corporate governance has positive influence on firm performance (Cheung et al., 2007: 94; Ammann et al., 2011: 41) and the necessity of people using the accounting information and financial who expect high levels of information reports that reflect the goals, accuracy, transparency, and are comparable and associated with decision-making (Heng & Noronha, 2011: 156). Today, such of accounting information and financial report are gaining interest from businesses from the trend that demands businesses to inclusively balance the interests of all stakeholders, not only shareholders or employees in organizations.

Theory and conceptual framework related to firm performance. Firm performance means net present value of future cash flows of organization or the ways to measure net present value of future cash flows of organizations through different points of view. Generally “value” is often referred to as “value” of assets. Based on financial approach, “value” can be comparable to cash equivalent and “business” is referred to as organizations or establishment (The Stock Exchange of Thailand, 2012).

Research Framework

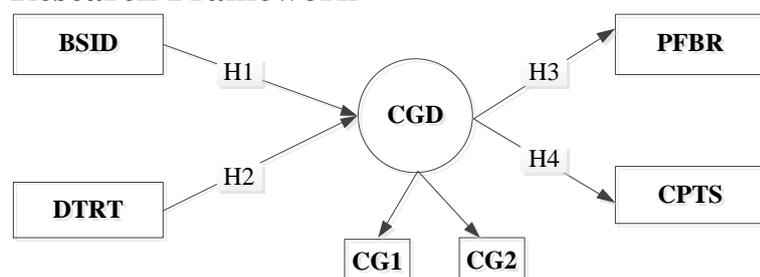


Figure 1 Research conceptual framework

Table 1 Abbreviation of variables and indicators

Variables	Variables Adopt	Measurement
Board Structure of Independent Director	BSID	Independent Director
Director's Relative	DTRT	Director's relative ratio
Corporate Governance Disclose	CGD	Number of items disclosure
Board's Role	CG1	Number of items disclosure
Good Corporate Governance Policy	CG2	Number of items disclosure
Profitability	PFBR	Profitability Ratio
Capital Structure	CPTS	Debt to equity ratio

Research hypotheses

H1: Board structure of independent director has direct positive influence on corporate governance disclosure.

H2: Board structure of director's relative has direct positive influence on corporate governance disclosure.

H3: Corporate governance has direct positive influence on profitability.

H4: Corporate governance has direct positive influence on capital structure.

Methodology

Population: The population in this study is companies listed on the Stock Exchange of Thailand in 2016, 970 companies (Data source dated on 1 January 2017, The Stock Exchange of Thailand, 2017). The samples selected to represent the population are under the 5 following conditions;

1. They are not MAI-listed companies since they cannot obviously identify objectives of fundraising which probably affects report on the corporate social responsibility and data analysis (Booth et al., 2000; Sukeharoensin, 2003).

2. They are not companies in financial business since companies in this business have operational structure, financial structure and some business transactions that are different from other groups of company. The Bank of Thailand issued regulations governing accounting record for financial institutions to set out accounting guidelines for financial institutions to apply them for the same standard in addition to the accounting standard regulated by Federation of Accounting Professions, (Notification of The Bank of Thailand about regulations governing accounting record for financial institutions, the Bank of Thailand, 2013).

3. They are not companies that are delisted from the Stock Exchange of Thailand. Due to the revocation of delisting securities, the companies shall be terminated listing status and unable to trade securities in the Stock Exchange (Regulations of the Stock Exchange of Thailand governing the delisting of listed securities, The Stock Exchange of Thailand, 1999).

4. They are not companies that being in a recovery period and Securities and Exchange Commission (SEC) ordered to revise financial statements because the companies shall be asked to stop trading securities in the Stock Exchange temporarily until the companies shall have successful business rehabilitation process (Guidelines on Disclosure of Information of Listed Company Entering into Business Rehabilitation Process under the Bankruptcy Act, The Stock Exchange of Thailand, 2000) or in the case that SEC order to rectify financial statements and re-submit such financial statements to the SEC office, then they shall be able to trade securities (Timely Disclosure of Information of Listed Companies, The Stock Exchange of Thailand, 2004).

5. They are not listed companies in the Stock Exchange of Thailand that corporate social responsibility disclosure or financial reports cannot be recorded since they shall have effect on data analysis (Booth et al., 2000; Sukcharoensin, 2003).

Based on the conditions of population sampling of the listed companies in the Stock Exchange of Thailand as mentioned above, there are suitable 698 companies that meet the criteria for having information for analyzing causal relationship of influence of board structure of independent director and director's relative on profitability and capital structure through corporate governance of the listed companies in the Stock Exchange of Thailand.

Sample: The sample size was determined by using the Yamane (1973)

$$\text{formula; } n = \frac{N}{1 + Ne^2}$$

Where

n = the sample size
 N = the size of population (970 companies)
 e = the error of 5 percent points (0.05)

Therefore, the sample size was

$$n = \frac{970}{1 + 970(0.05)^2}$$

The researcher calculated the required sample size and it came up with 254.28 companies. So, the sample size for this study was equal to 254 companies.

Research Format: The researcher recorded statistics of corporate governance disclosure in a statistics collection form for corporate governance disclosure. The information were collected from corporate governance report in 2016 in terms of structure of independent director and director's relative, profitability and capital structure. Information were verified and collected from annual report (Form 56-1) and financial statement of companies listed in the Stock Exchange of Thailand for the 2016 accounting period.

The statistics used to analyze data: Structural Equation Model; a multivariate statistical analysis technique was used to analyze structural relationships. Multiple Indicators and Multiple Causes (MIMIC) Model were employed by the researcher to analyze data.

Research Results

The analysis results from the structural equation model about the influence of board independence on ability to operate and capital structure through corporate governance disclosure of the companies listed on the Stock Exchange of Thailand found that the models based on hypotheses were consistent with the empirical data. The researcher carried out confirmatory factor analysis of variables in this study as seen in figure 2 and Table 2.

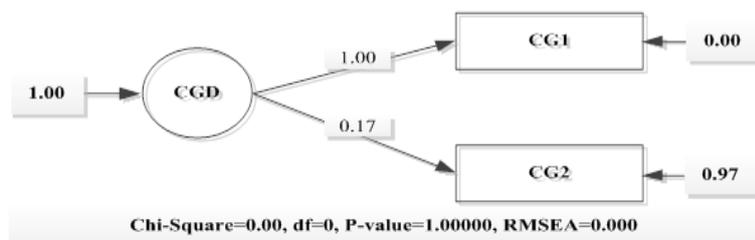


Figure 2 Confirmatory Factor Analysis: Corporate Governance Variable

Table 2 Confirmatory Factor Analysis

Variables	b	Factor SE	t	R ²
CG1	1.00	-	-	1.00
CG2	0.17	1.65	3.45	0.03

$\chi^2 = 0.00$, $df = 0$, $p\text{-value} = 1.00$, $RMSEA = 0.00$

Note: $|t| > 1.96$ means $p < .05$; $|t| > 2.58$ means $p < .01$

The analysis results of measurement model by analyzing factors of corporate governance disclosure (CGD) indicated that the model was consistent with the empirical data after model adjustment without cutting out any indicators. The Chi-square statistical test result was 0.00, the statistical probability (p) was 1.00, degree of freedom (df) was 1, RMSEA was 0.00, SRMR was 0.00, GFI was 1.00, CFI was 1.00, and AGFI was 1.00.

In other words, corporate governance disclosure (CGD) consisted of 2 components; Board's role (CG1) and good corporate governance policy (CG2). The Board's role (CG1) was the most important, followed by good corporate governance policy (CG2). After the researcher

finished fitness test of variables, data were taken to the process of hypothesis testing as seen in the figure 3.

Path analysis before model adjustment

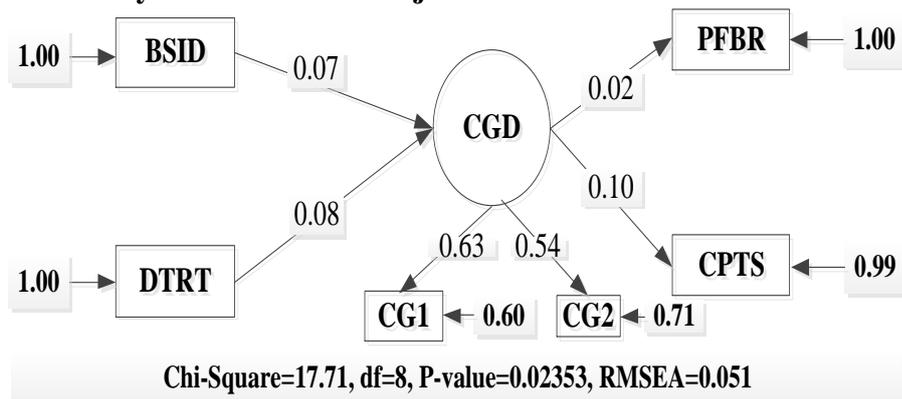


Figure 3 Analysis of Hypothetical Model before Adjusting the Direction of Influence

Path analysis after model adjustment

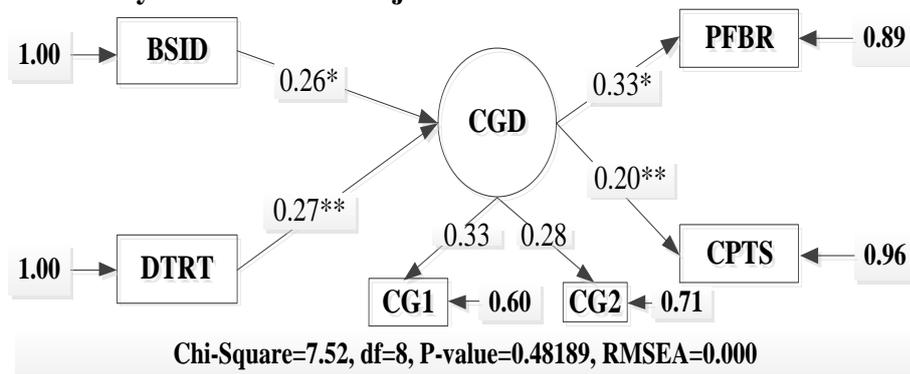


Figure 4 Analysis of Hypothetical Model after Adjusting the Direction of Influence

Table 3 Result of Direction of Influence Analysis

Dependent Variables/ Independent Variables	CGD			PFBR			CPTS		
	TE	DE	IE	TE	DE	IE	TE	DE	IE
BSID	0.26* (0.01)	0.26* (0.01)	-						
DTRT	0.27** (0.05)	0.27** (0.05)	-						
CGD				0.33* (3.24)	0.33* (3.24)		0.20** (3.14)	0.20** (3.14)	-

$\chi^2 = 7.52, df = 8, \chi^{2/2} = 0.94, p\text{-value} = 0.48, RMSEA = 0.00$

Note: p* < .05; p** < .01

Table 4 The analysis of the index of item-objective congruence model

Index of item-objective congruence	Criteria	Measured index	Result
χ^2/df	< 2.00	0.94	Pass
CFI	≥ 0.95	1.00	Pass
GFI	≥ 0.95	0.99	Pass
AGFI	≥ 0.90	0.99	Pass
RMSEA	< 0.05	0.00	Pass
SRMR	< 0.05	0.02	Pass

The measurement of causal relationship model of company characteristics (Char) found that the models based on hypotheses were consistent with the empirical data. The Chi-square test result was 7.52, the statistical probability (p) was 0.48, degree of freedom (df) was 8, χ^2/df was 0.94, RMSEA was 0.00, SRMR was 0.02, GFI was 0.99, CFI was 1.00, and AGFI was 0.99.

Latent variables in proportion of independent director (BSID) had direct positive influence on corporate governance disclosure (CGD) with a statistical significant level of .05 and at coefficient value of 0.26.

Latent variables in proportion of Director's relative (DTRT) had direct positive influence on corporate governance disclosure (CGD) with a statistical significant level of .01 and at coefficient value of 0.27.

Latent variables in corporate governance disclosure (CGD) had direct positive influence on profitability (PFBR) with a statistical significant level of .05 and at coefficient value of 0.33 and had direct positive influence on capital structure (CPTS) with a statistical significant level of .01 and at coefficient value of 0.20.

The research result indicated that board structure of independent director and director's relative had direct positive impact on profitability and capital structure of the companies listed on the Stock Exchange of Thailand. The research result was consistent with the determined hypothesis as seen in the Table 5.

Table 5 Test results of research hypotheses

Research hypotheses	Test results of the hypotheses	Direction of influence
H1: Board structure of independent director had direct positive influence on corporate governance disclosure.	Acceptable	+(*)
H2: Board structure of Director's relative had direct positive influence on corporate governance.	Acceptable	+(**)
H3: Corporate governance had direct positive influence on profitability.	Acceptable	+(*)
H4: Corporate governance had direct positive influence on capital structure.	Acceptable	+(**)

Remark: + means significantly positive influence with significant elements
 - means significantly negative influence
 # means no influence insignificantly.

Conclusions and Research Discussion

The study results indicated that board structure of independent director and director's relative had direct positive influence on profitability. It can be said that when independent directors had more freedom, firm performance would be increased consistently. In the past, the research result of Beiner, Drobetz, Schmid & Zimmermann (2004) found that proportion of

shareholding and board independence had positive influence on enterprise value. The result of this study revealed that board structure of director's relative had direct positive on profitability. This study result was different from that of the research conducted by Connelly et al. (2012) which found that family-owned companies had lower firm performance than companies run by professional executives hired from outside. The researcher would like to share opinion that the difference was caused by the difference in period of the study. Moreover, at present companies realize about corporate governance in an understanding manner more and more. Groups of executives strictly follow the rules and regulation. Consequently, the present study results involved with board structure of director's relative has direction of influence not different from management by independent directors hired from outside who are not company's stakeholders. The study result about corporate governance disclosure found that corporate governance disclosure had direct positive influence on profitability. Namely, strict corporate governance rules enable companies to improve profitability. This research result did not give any differences from the past that found that board independence had influence on corporate governance and increased ability to operate and profitability significantly (Mohammad, 2008: 282; Kajola, 2008: 14). The other research result also found that management based on corporate governance had influence on firm performance. Good corporate governance. Good corporate governance of companies scored high corporate governance had impact on company's better firm performance (Cheung et al., 2007: 94; Ammann et al., 2011: 41). This study can credibly confirm the studies in the past. Currently, it has been acceptable that if companies require improvement on profitability ratios and capital structure, they have to give importance to corporate governance disclosure in a sufficient way.

Recommendation

1. Continuous research should be conducted on relationships between independent variables in corporate governance in terms of measurement of financial performance such as a growth rate of income which can help broaden body of knowledge about corporate governance.
2. Continuous research should further provide qualitative view of additional information and expand in-depth study results to profitability and capital structure.
3. Further research should be further conducted by using this conceptual framework on the population being MAI-listed companies to confirm research results.
4. Further study should be additionally conducted by using this conceptual framework with industry groups so as to penetrate study results and confirm research results.
5. Further study can expand study results based on this conceptual framework and company sustainability should be studied with practices that follow this research results so as to additionally expand study results.

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