Corporate Governance, High Net-Worth Construction Companies and Firm’s Performance – Evidence from Warsaw Stock Exchange in Poland

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Abstract: This study is aimed at examining the effect of corporate governance mechanism on the firm’s performance in Polish construction industry. The mechanism involves the company’s board size, board composition, gender diversity, and ownership concentration. The data are collected from ten listed construction companies in Warsaw Stock Exchange in year 2015. Deploying cross-sectional regression in estimating the model, the empirical results uncover a moderate impact of the corporate governance mechanism on the firm’s performance. Among the four governance mechanisms, only gender diversity demonstrates a significant impact on the firm’s performance. Meanwhile, board size, board composition, and ownership concentration do not exhibit significant impacts on the firm’s performance. The results of this study contribute to the existing literature and provide useful information concerning the practice of corporate governance mechanism in risky business like Polish construction industry.

Keywords: corporate governance mechanism, return on assets, high net-worth, board size, ownership concentration, Warsaw Stock Exchange.

1. INTRODUCTION

Corporate governance is a structure used to direct and control the business practice of an organisational economic system to attain success. Corporate responsibility aims to acknowledge the shareholder value while considering other stakeholders. Generally, the top managerial staff is accountable for all governance-related matters in any organisation. To institute a reliable corporate structure, the shareholders must engage the executives and the auditors for the wellbeing of the company and fulfill their needs (Cadbury Report, 1992). Corporate governance entails the components that can guarantee the venture-based return for the enterprises (Shleifer et al., 1999). It does not only focus on the internal administration aspect of a firm but also emphasizes the relationship between a firm and its suppliers, customers, and other stakeholders. The emerging need for stocks and other organisational assets has highlighted the role of corporate governance worldwide. Raising the
investment fund and managing the firm liquidity, while increasing the profitability of a firm, remain challenging for numerous business organisations.

Corporate governance has become a well-known corporate guideline nowadays. In general, corporate governance determines the establishment of a firm that defends the stakeholders’ expectations by considering the situation worldwide. However, the state of the corporate governance varies with countries due to the different economic, racial, and social backgrounds. For instance, organisations in the rich countries have legislative frameworks with separate shareholders’ jurisdictions, stable politics, and budgetary financial structures.

As the corporate governance varies with entities and regions, it is crucial to standardize to gain a high rate of return for the investors and prevent any motive for private financial gain (Luo, 2007). A feeble corporate governance or non-compliance would lead to corporate frauds, financial abuses, and high losses (Niamh and Jill, 2008). This paper, therefore, aimed to examine the following questions: (1) Is the corporate governance mechanism effective in improving the firm performance of the listed construction companies in Poland? (2) Does any relationship exist between the corporate governance mechanism and the firm performance of the listed construction companies?

2. LITERATURE REVIEW

2.1. Board Size

Board size and firm size are related to each other (Dalton et. al. 1999), whereby the board size is associated with the firm performance (Kiel and Nicholson 2003). Using regression with panel data, Ujunwa (2012) highlighted that board size and CEO/chairman duality functions have a negative impact on the firm performance, while board independence has a positive impact on the corporate governance and the firm performance. Nevertheless, Masood et. al. (2013) found that board size has no effect on the firm performance. Similar findings were reported by Dalton et al. (1999) who claimed that it is actually the number of outdoor administrators that matters.

From the standpoint of an organisation, larger corporations require a superior board to regulate and observe the administration-related affairs (Kiel and Nicholson 2003). As proposed by an agency philosopher (Jensen, 1993), the ideal number of board members should be around eight. Furthermore, Lipton and Lorsch (1992) proposed that a board size of ten members should be considered as extreme because it restricts the team subtlety and obstructs the board presentation. To date, most studies regarding the corporate governance revolve around the agency theory. This research scrutinized the significance of board size on the performance of corporate governance and the financial statements.

2.2. Board Composition

Board composition is a corporate governance mechanism that involves a board structure which allows the communication between the executive and the non-executive directors. Weir and Laing (2001) stated that there are reasons why practical evidence is inadequate to support the association between non-executive directors and enactment. The boards with more non-executive directors are based on agency theory. In this case, it suggests that a board should have more non-executive directors who are anticipated to perform better due to their freedom in decision-making, instead of being constrained by the company administration (Dalton et. al. 1998; Chidoko and Mashavira, 2014; Salvioni and Gennari, 2014; Razek, 2014; Ali, et.al. 2016; Eshiet, 2017; Mejdoub and Arab, 2017; Chang’ach, 2018; Omodero and Ogbonnaya, 2018).
On the other hand, the executive director on a board is in line with the stewardship theory as it supports the claim that leaders are good stewards who spend their time and energy to maximize the profit for the company and the stakeholder (Donaldson and Davis, 1994; Romli and Ismail, 2014; Ekpung, 2014; Sarwar and Mubarak, 2014; Bollazzi and Risalvato, 2018; Oitsile., Galebotswe and Sekwati, 2018). Beasley (1996) reported that the boards which are dominated by external directors could justify their observing roles with respect to the financial reporting. Similarly, Masood et. al., (2013) found that board independence has a positive influence on the firm performance.

2.3. Gender Diversity

A lack of female directors being involved in the board decisions is a crucial issue disclosed at the World Economic Forum in the World Gender Gap Index 2009. As demonstrated by Julizaerma and Zulkernain (2012), the Malaysian government has a policy which mandates a minimum of 30% women directorship in the board decisions of the financial departments. Despite the policy, the number of females holding any position on the board decreased from 2005 to 2007, with 10.2% female board members in 2005, followed by 7.6% in 2006 and 5.3% in 2007. However, according to the Ministry of Women, Family, and Community Development, the number of female board members increased to 7.41% in 2008 (kpwkm).

The influence of women as directors on the company’s profit has been well-established by numerous previous studies (Shrader et. al, 1997 and Maran and Indraah, 2009). Julizaerma and Zulkarnain. (2012) reported a significant impact of female directors on the firm performance. Moreover, Catalyst (2008) demonstrated that on average, 4500 companies with a higher number of female administrators met their financial targets as compared to other companies with lesser female administrators. In the study, companies with more female administrators were shown to have 53% higher return on equity, 66% higher return on invested capital, and 42% higher return on sales. Wang and Clift (2009) explained that gender has no significant effect on the firm performance.

2.4. Ownership Concentration

Chang (2003) stated that most of the financial institutions play a role as the middle operator to invest in businesses. To control risks, different incentives and risk assessment are required before making any decision because the companies which are scrutinised prior to an investment perform higher in their business (Kamarudin et al., 2018). Most foreign investors believe that companies with a sound corporate governance are more effective in their operation, thus reducing the agency cost and resulting in lower financial risks (Leuz et. al. 2008). Investors from the financial institutions often have a significant amount of stocks in various corporations. Hence, it is natural for them to safeguard their interest by observing how an administration is run and implementing rules to the managers (Chang, 2003). Lei and Teen (2005) discovered a positive association between the assets owned by the financial institutions and the corporate governance level for public corporations. Kole and Mulherin (1997) studied corporations in which some of the shares are owned by the federal government possession. About 35% of the performance of these corporations were different from the private corporations when comparisons were made between the companies from the same industry. In addition, McConaughny et. al. (2001) noticed the tendency for the corporations with spouse involvement and/or family business to adopt standard operating procedures, making them the reliable prospects for investment. This finding was consistent with that reported by Yammeesri and Lodh (2001) whereby the company profit is
better when their spouses or family members have a share in the business.

2.5. Firm Performance (Return on Assets)

ROA is an indicator used to represent the market returns and measure the productivity in regards to firm performance (Haniffa and Hudaib, 2006). Therefore, in this study, the firm performance was evaluated by measuring the ROA. Saleh and Zuraidah (2012) demonstrated that the firm performance is inversely correlated with the corporate governance. Kevin et al. (1994) revealed that the level of return on assets (ROA) increased with the ownership concentration but declined once the ownership concentration surpassed 68.2%. Similar results were reported by Morck et al. (1988) where the firm performance increased as the administration ownership increased from 0% to 5% but declined when the administration ownership continued to grow from 5% to 25%.

Bilal et. al., (2013) highlighted a significant impact of board size and CEO duality on the ROA but not the board composition. Generally, corporate governance influences the firm performance (Hussain et al., 2018). Less than 4% of the firms owned by Brazilian adopted a “good” corporate governance practice, and only the firms with a sound corporate governance were shown to achieve high performance in terms of ROA (Andre et al. 2005).

Background of the Study

The Poland Warsaw Stock Exchange (WSE) was first operated in 1817 but it was closed for more than 50 years due to the Second World War and the introduction of centralised economy after the war (Kowalewski et al. 2007). The WSE was reopened in 1991 with only four former state-owned companies being listed. Since then, the market grew gradually through the initial public offerings (IPOs) of the former state-owned companies and privatisation, which resulted in an increase in the public companies with a large market capitalisation. In 1999, the number of listings exceeded 200. Today, the Polish stock market is dominated by the large private companies. As privatisation dominates the stock market, the recent IPOs are allocated to the private small and medium-sized enterprises (SME), where most of the companies are founded in the last two decades (Kowalewski et al. 2007).

Moreover, the growth of WSE and increase of share by foreign investors stimulate an improvement in terms of the standard of the corporate governance. In relation to the approach in the regulation of securities market and investor protection, Berglof and Pajuste (2003) classified Central and Eastern European Countries (CEEC) countries into four categories. According to this study, Hungary and Poland have the strictest regulatory mechanisms, with the aim to protect investors from management and prevent the large block holders from committing fraud. Furthermore, these two countries also endeavour to empower the enforcement due to the existence of loopholes in the legal framework in their economy.

The studies conducted on ownership structure in CEEC found that there is a strong ownership concentration of companies in this region. Based on the listed companies in Poland in 2000, the median voting power held by the largest share owner in those companies was recorded at 39.5% (Pajuste, 2002). This value is close to the figures observed in the mainland Europe, for example, Austria and Italy with their median voting power being 54.1% and 52.3%, respectively. Hence, it can be concluded that corporations in Poland operate under the influence of investors from the regulatory and strategic aspects. The internal shareholders are reluctant to pay dividends to the external shareholders, causing the minority
shareholders to have weaker rights and lower dividend offered to them. Investors who hold a large number of shares can appoint the majority of the managers and supervisory board members. In Poland, the dual-class share structure and the stock pyramids are the main elements that restrict the control of the blockholders over a firm while maintaining a fraction of cash flow. Consequently, there have been cases of abuse of minority rights by the shareholders in control in Poland (Kowalewski et. al. 2007).

3. THEORETICAL FRAMEWORK

The impacts of board size, board composition, gender diversity, and ownership concentration on the firm performance have been empirically established by the existing literature. Therefore, these governance mechanisms were considered as the independent variables. Meanwhile, the firm performance signified by ROA was regarded as the dependent variable. The relationships between these independent variables and firm performance were hypothesised as follows:

H1: Board size is negatively related to the firm performance.
H2: Board composition is positively related to the firm performance.
H3: Gender diversity is negatively related to the firm performance.
H4: Ownership concentration is negatively related to the firm performance.

4. METHODOLOGY

A total of ten firms listed in the WSE with the highest net worth in the construction industry was selected. This sample size was almost equivalent to that of Eisenhardt (1989) whereby eight firms were included in the study. The data pertaining to board composition, board size, gender diversity, ownership concentration, and ROA were collected from the annual reports of each company for the financial year ended 31 December 2015. The ROA data were obtained from the balance sheet in the annual reports.

4.1. Model

A regression analysis approach was used in this research because it facilitates the removal of unobserved firm heterogeneity (Bilal, 2013). Furthermore, Yasser (2011) discovered that the regression analysis is more efficient, provides better information, and has less collinearity between the variables. Studies that focus on the board characteristics and the corporate governance are influenced by agency theory, resource dependence theory, and stewardship theory.

The research was conducted to assess the effect of corporate governance on the firm performance and evaluate the construction industry in Poland. The model used was as follows:

\[ \text{ROA} = a + b_1 \times (\text{BS}) + b_2 \times (\text{BCMB}) + b_3 \times (\text{GD}) + b_4 \times (\text{OC}) + e \]

4.2. Research variables and measurements

Table 1 showed the variables and the measurements used in this study to evaluate the effect of corporate governance mechanisms.

5. EMPIRICAL RESULTS

The impacts of the four corporate governance mechanisms, namely board composition, board size, gender diversity, and ownership concentration were presented in relation to the firm performance which was measured by ROA.

Table 2 illustrated the descriptive statistics used for the variables in this study to measure the effect of corporate governance mechanisms.

Based on the descriptive statistics, all the high net-worth firms had a positive ROA. The average board size was eleven. There was no specific definition of the board size.
and every board can determine its size for the company’s effectiveness. The board composition by the management board was 40%, suggesting that the majority of the board members were not related to directors who were in charge of the management. Furthermore, the average percentage of women holding the position as the directors was 11%, in which the construction companies were regarded to have low corporate governance standard. In addition, about 32% of the top three shareholders had more ownership rights which could potentially threaten the minority shareholders. The establishment of the Corporate Governance Best Practices in 2007 aimed to provide regulatory checks and balances for the public firms in Poland.

As portrayed in Table 3, all the independent variables moderately affected ROA. The value of 0.292 indicated that board size, board composition by the management board, gender diversity, and ownership concentration had no significant impact on the firm performance collectively. Table 4 presented the coefficient value of the model which was 57.11%, implying that 57.1% of the change in the ROA was due to the change in the corporate governance mechanisms.

Predictors: board size, board composition by management board, gender diversity, ownership concentration

Additionally, the results demonstrated that the effect of board size, board composition, and ownership concentration on ROA was statistically insignificant, while gender diversity had a significant impact on the ROA.

6. DISCUSSIONS AND LIMITATIONS

Results from Table 5 showed a positive relationship between gender diversity and ROA. The value of 0.0924 showed that gender diversity had an impact on the firm performance at 10% significance level. This finding was consistent with that discovered by Julizaerma and Zulkarnain (2012). Meanwhile, board composition had no significant impact on the firm performance, which was similarly reported by Vafeas and Theodorou (1998). Having more directors on the management board lowered the firm performance which could be explained by the inability of the companies to fully utilise the role of board directors. Furthermore, this study demonstrated no effect of board size on the firm performance, which was again similar to the findings reported by Julizaerma and Zulkarnain (2012). Based on this finding, it can be postulated that the directors could be on the board merely to fulfill the board composition requirements or to portray the independence of the board. The t values for board size, board composition, gender diversity, and ownership concentration were 0.77, 1.16, 2.08, and 1.43, respectively.

Andersen et al. (1989) stated that a business plan can be made successful when the firms start to explore their underlying asset. A cost-benefit analysis is useful for any entity to employ its resources to gain competitive advantages over its competitors and sustain a high profit for the company (Barney, 1991). Therefore, the firm performance is determined by its ability to maintain low cost, to adapt to changes, and to outline manufacturing policy and corporate governance practice (Hill, 2000).

This study had several limitations. Firstly, there were only ten listed companies being included. The small sample size would increase the difficulty to make deduction representing the population from the results of this study. Moreover, the sample was based on companies from the construction industry and therefore, not applicable to other sectors, such as manufacturing, tourism, and agriculture in Poland. In addition, ROA was used as the only quantitative measure of the firm performance in this study. The other indicators, such as stock price performance and return on sales (ROS) were not
considered, therefore limiting the validity of the results obtained from this study.

REFERENCES


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Table 1: Variables and Data Sources

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Board Size (BS)</td>
<td>Total number of directors in the firm</td>
</tr>
<tr>
<td></td>
<td>Data source: Julizaerma and Zulkernain, 2012.</td>
</tr>
<tr>
<td>Board Composition by Management board (BCMB)</td>
<td>Proportion of total number of directors and directors on management board</td>
</tr>
<tr>
<td></td>
<td>BC=MB/TD</td>
</tr>
<tr>
<td></td>
<td>MB= directors on mgt board, TD= Total nob. of directors.</td>
</tr>
<tr>
<td></td>
<td>Data source: Bilal et. al. 2013</td>
</tr>
<tr>
<td>Gender Diversity (GD)</td>
<td>Proportion of total number of female directors and directors on board</td>
</tr>
<tr>
<td></td>
<td>Data source: Julizaerma and Zulkernain, 2012.</td>
</tr>
<tr>
<td>Ownership concentration (OC)</td>
<td>Percentage of top three shareholders to total nob of shares</td>
</tr>
<tr>
<td></td>
<td>Data source: Lu et. al. 2015.</td>
</tr>
</tbody>
</table>

Dependent variable

| Return on Assets (ROA)                           | Return on Assets, Calculated by Net Income divided by Total Assets. It is |
|                                                  | a measure financial efficiency in utilizing company’s total assets.       |
|                                                   | Data source: Saleh et. al. 2012.                                          |

Table 2: Descriptive Statistics

<table>
<thead>
<tr>
<th>Tested Variables</th>
<th>N</th>
<th>Mean</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>10</td>
<td>10.82%</td>
</tr>
<tr>
<td>Board Size (BS)</td>
<td>10</td>
<td>11</td>
</tr>
<tr>
<td>Board Composition by Management Board (BCMB)</td>
<td>10</td>
<td>40.17%</td>
</tr>
<tr>
<td>Gender diversity (GD)</td>
<td>10</td>
<td>10.76%</td>
</tr>
<tr>
<td>Ownership concentration (OC)</td>
<td>10</td>
<td>32.26%</td>
</tr>
</tbody>
</table>

Table 3: ANOVA

<table>
<thead>
<tr>
<th>Analysis of Variance</th>
<th>DF</th>
<th>Sum of Squares</th>
<th>Mean Square</th>
<th>F value</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Model</td>
<td>4</td>
<td>1.29245</td>
<td>0.32311</td>
<td>1.66</td>
<td>0.2924</td>
</tr>
<tr>
<td>Error</td>
<td>5</td>
<td>0.97048</td>
<td>0.19410</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corrected Total</td>
<td>9</td>
<td>2.26293</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Table 4: Summary of the Model

<table>
<thead>
<tr>
<th>Parameter</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Root MSE</td>
<td>0.44056</td>
</tr>
<tr>
<td>R-Square</td>
<td>0.5711</td>
</tr>
<tr>
<td>Dependent Mean</td>
<td>1.08284</td>
</tr>
<tr>
<td>Adj R-Sq</td>
<td>0.2281</td>
</tr>
</tbody>
</table>

Table 5: Regression Results of Corporate Governance Mechanisms in Construction Companies on 2015

<table>
<thead>
<tr>
<th>Variable</th>
<th>Parameter Estimate</th>
<th>Standard Error</th>
<th>t Value</th>
<th>Sig.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intercept</td>
<td>2.89903</td>
<td>1.00678</td>
<td>2.88</td>
<td>0.0346</td>
</tr>
<tr>
<td>BS</td>
<td>-0.07286</td>
<td>0.09469</td>
<td>-0.77</td>
<td>0.4764</td>
</tr>
<tr>
<td>BCMB</td>
<td>-2.72747</td>
<td>2.34607</td>
<td>-1.16</td>
<td>0.2975</td>
</tr>
<tr>
<td>GD</td>
<td>-3.38116</td>
<td>1.62787</td>
<td>-2.08</td>
<td>*0.0924</td>
</tr>
<tr>
<td>OC</td>
<td>0.01379</td>
<td>0.00962</td>
<td>1.43</td>
<td>0.2109</td>
</tr>
</tbody>
</table>