



An Integrative Proposed Model of Corporate Governance: The Corporate Governance Mechanisms Mediates the Relationship between Board Intellectual Capital and Corporate Performance

Seyed Taghi Pardis^{1*}, Saudah Sofian², Dewi Fariha Abdullah³

¹Faculty of Management, Universiti Teknologi Malaysia, Skudai Johor, Malaysia, ²Faculty of Management, Universiti Teknologi Malaysia, Skudai Johor, Malaysia, ³Faculty of management Universiti Teknologi Malaysia, Skudai Johor, Malaysia.

*Email: stpardis@yahoo.com

ABSTRACT

Corporate governance (CG) foster dynamic economic growth, increase financing, reduces costs of capital, manage stakeholder interest which ultimately increase corporate performance (CP). Researchers have argued that employees must be inspired by CG practices to manage the conflicts of interest. There is a growing need for integrative model for CG, however the gaps are still exist in the literature on CG mechanism (CGM) and their mediating role to influence the interlinkages between board intellectual capital (BIC) and CP. This study propose an integrative model CG by reviewing the literature CGM, prior models and relevant constructs of BIC, structures, process, and performance. This paper synthesizes the thinking arising from the review of previous literature and models of CG, and proposes an integrative research model. From the perspectives CG, this study argues that the new model should explore the relationship among BIC, CGM and CP.

Keywords: Intellectual Capital, Corporate Governance, Performance

JEL Classifications: G34, O16, O34

1. INTRODUCTION

In 21st century knowledge economies, intellectual capital (IC) of the firms is catalyst to achieve business goals, remain competitive and improve corporate performance (CP) (Earnest and Sofian, 2013). It is concerned with recognizing and assessing the elusive resources that contribute to value creation. It is "economic value" attached to three categories of intangible resources, namely, human capital (HC), organizational capital and social capital (Sullivan, 1998; Spender et al., 2013). IC is sum of all existing knowledge that is implanted in the human resource, organizational routines and networks of an organization (Kong and Thomson, 2009). IC is distinctive competency which enables an organization to gain and maintain competitive advantage (Kong and Prior, 2008). Although many studies have been conducted to tape the impact of different constituents of IC (e.g., HC, structural capital, internal and external relational capital) have on CP (Perrez-Arrau et al., 2014). Recently findings by Heisig (2014), on this basis his 221

interviews of Knowledge Management expert around the globe, suggested that researcher should address the value contribution of knowledge management and aim towards a behavioral turn in their study with more emphasis on human and social factors. Particularly, the impact of board IC on its performance is yet to be unveil.

Beside IC, corporate governance (CG) is another instrumental for better CP, as it directs and monitors the corporate affairs (Sarbah and Xiao, 2015). The importance of CG increased from the collapse of financial institutions during Asian financial crisis in 1997-1999, which is led to focus on board structure. Then, there were major corporate frauds and accounting scandals in developed countries (e.g., Enron, WorldCom in the US, Parmalat Maxwell and Polly Peck in Europe and HIH insurance in Australia) in the early 2000. Finally, recent global economic crisis of 2008/2009 explodes after Lehman Brothers Holdings bankruptcy, the largest bankruptcy proceeding in US history (Wiggins et al., 2014). Eventually, there

have been raised serious doubts about the effectiveness of board in protecting the interest of shareholders and other stakeholders.

CG revolve around board as they devise business strategies, ensure monitoring and control, and play advisory role (Adams et al., 2010; Agrawal and Knoeber, 2000). Hence, board of directors (BOD) has vital player in providing “good CG” to a corporation (Romano and Guerrini, 2014). The conflicting nature of the stakeholders’ interest makes the role of board even more pivotal. Therefore, board IC (BIC) can create value for the organization and improve CG mechanism (CGM) through knowledge, experience, information, relationships, routines, procedures, and spirituality.

CGM (board structures, board processes and board performance) remained a center of attention of academicians and practitioners (Mehrabani, 2012). This attention has been based on the embedded utility of CG in better CP, and development of capital markets in an economy (Sarbah and Xiao, 2015). There are many studies which explores the impact one component of CGM on other like impact of board structure, and process, on board performance (Ali and Nasir, 2014; Eulerich et al., 2014). While other studies explore board mechanisms relationship with CP (Fauzi and Locke, 2012; Viet, 2013; Ahmed Sheikh et al., 2013 and Johl et al., 2015). There is no evidence that CGM was incorporated as mediator in relation of IC and CP. This study aims to fill this gap by examining the mediating effects of CGM on the relationship between BIC and different dimensions of CP.

The concept of CP merges from the efficiency of the company and achieve its objectives being the major affair for the corporate in the long run to survive. The continuous value creation and long-term business performance is related to the board activities and performance (Monks and Minow, 2008). According to Ogbechie (2012), the company performance is reflected from both quality and the effectiveness of its directors. Given the significant role of the boards in the organizations, it is still important to understand the level of influence of BOD on CP.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

The literature on all the variables of proposed framework and their interrelationships have been articulates in subsequent section in order to draw hypothesis.

2.1. BIC and CP

For achieving superior performance and competitive advantage, companies are investing in intangibles assets (Salehi et al., 2014). The existence of IC has been frequently recognized as invaluable intangible asset, which closely related with the development of strategic decisions and improve CP (Brooking, 1997; Stewart and Ruckdeschel, 1998; Bounfour, 2003). Roos et al. (2007) defined IC as all non-monetary and non-physical resources that are fully or partly controlled by the organization and that contribute to the organization’s value creation. Apart from three generally accepted components of IC (human, structural, and relational

capitals), Ismail (2005) added another component that is called spiritual capital (SpC) as the fourth element of IC.

In last decade, many researchers have studied the effect of IC components on CP. The findings of majority of these studies conclude that IC is positively associated CP (Sofian et al., 2006; Zerenler and Gozlu, 2008; Kamukama et al., 2010; Sharabati et al., 2010; Phusavat et al., 2011; Abdullah and Sofian, 2012; Sumedrea, 2013; Jamshidy et al., 2014; Salehi et al., 2014; Abdullah et al., 2015). In the context of the BIC, Nicholson and Kiel (2003) defined IC as the collection of knowledge, information, experience, relationship, routines, procedures and culture that the board may employ to create value (Stewart, 1997). Ironically, little attempt has been made so far to measure the impact of BIC on CP. Based on this evidence and theoretically grounding on HC theory of Becker (1978), the current study hypothesis that BIC would also positive impact on CP. In this study, BIC has two components: HC and SpC. HC in this study related to knowledge, skills and abilities possessed by directors (Nicholson and Kiel, 2004) while SpC relates to morale, faith, honesty, ethics, desire and motivation, commitment, self-esteem, enthusiasm and sincerity. The preceding research gap and arguments propose the following hypothesis for verification:

H1a: The board’s HC has positive relationship with CP.

H1b: The board’s SpC has positive relationship with CP.

2.2. BIC and CGM

The CGM, refers to the structure of board, its functionality (board process) and output (board performance). BOD and their capacity plays a primitive in CGM as competent and knowledgeable directors can design effective mechanisms which would yield all stakeholders’ objectives (Huyghebaert and Wang, 2012). The notion of agency theory, resource based view, stakeholder theory and resource dependency theory, theoretically support the argument that boards and their abilities are key to board mechanisms.

Board structures refers to the board size, independent directors, and gender diversity. After going through literature, it is evident, that previous research has studied the impact of board structure on board performance (Scarborough et al., 2010; Minichilli et al., 2012; Saat et al., 2011; Amoli and Esmaeil, 2013; Kim et al., 2014), board processes (Adams et al., 2010; Mande et al., 2013) and CP (Fauzi and Locke, 2012; Ahmed Sheikh et al., 2013; Alamer et al., 2015; Lückcrath-Rovers, 2013; Wijethilake et al., 2015). But no one has seen board structure as outcome variable, particularly exploring the impact board’s IC on board structure. For instance, the competency, dedication, and moral values, of directors can have influence on board size, inclusion of independent directors, and female directors. Hence, current study set forth follow hypothesis for validation:

H2a: The board’s IC has relationship with board structure (board size).

H2b: The board’s IC has relationship with board structure (board independence).

H2c: The board's IC has relationship with board structure (gender diversity).

Board process refers to the ways directors interact and behave as they carry out their duties (Finkelstein and Mooney, 2003). Forbes and Milliken (1999) have classified board process into three categories: (1) Effort norms (2) cognitive conflicts and (3) use of Knowledge and Skills. Effort norm represents vigor of individual's behavior (Kanfer, 1990), cognitive conflict refers to "task-oriented differences in judgment among group members" (Forbes and Milliken, 1999), and "Functional knowledge and skills" cover expertise in critical business areas such as accounting, law, and marketing (Ong and Wan, 2008). Literature reviews reflects that in all major CG frameworks (Forbes and Milliken, 1999; Nicholson and Kiel, 2004; Levrau and Van den Berghe, 2007; Ogbechie, 2012), board process were used as intervening variable between an independent variable and board performance. These studies further reveals that board processes have positive relationship with board performance. There hardly any study which has check the influence of BIC on board process. Hence, current study set forth follow hypothesis for validation:

H3a: The board's IC has relationship with board process (effort norm).

H3b: The board's IC has relationship with board process (cognitive conflict).

H3c: The board's IC has relationship with board process (use of knowledge and skills).

Board performance refers to the ability of the board in executing its roles. Zahra and Pearce (1989) have identified three main role regarding board includes monitoring and control, service, and strategic management. Monitoring and control tasks pertains to "watchdog" role of board members (Chen, 2008), service role is related to advisory and counseling of CEO (Guest, 2008), strategic role requires board involvement in formulation of vision, mission, and strategies (Machold et al., 2011; Machold and Farquhar, 2013). In existing literature board performance is always assumed as an outcome of board structures and processes (Minichilli et al., 2009, 2012; Zattoni et al., 2015; Ong and Wan, 2008; Ogbechie, 2012) and there in scarcity of evidence in literature, where relationship of board's IC with board performance was established. Hence, current study set forth follow hypothesis for validation:

H4a: The board's IC has relationship with board performance (monitoring and control).

H4b: The board's IC has relationship with board performance (service).

H4c: The board's IC has relationship with board performance (strategic).

2.3. CGM and CP

CP reflects the effectiveness of organization operation and therefore considered as massively explored area in organization

research (Palacios-Marqués et al., 2013). In last decade there have been an influx of studies measuring the impact of board structure (Fauzi and Locke, 2012; Viet, 2013; Ahmed Sheikh et al., 2013; Ali and Nasir, 2014; Johl et al., 2015), board process and board performance (Forbes and Milliken, 1999; Levrau and Van den Berghe, 2007; Ogbechie, 2012; Jamshidy et al., 2014; Zattoni et al., 2015) on CP. Hence, in this study we will reaffirm the relationship of constituents of CGM on CP and also to complete the sequential relationship of our proposed theoretical framework. Hence, we propose our hypothesis as follows:

H5a: The CGM (board structure) has relationship with CP.

H5b: The CGM (board process) has relationship with CP.

H5c: The CGM (board performance) has relationship with CP.

2.4. Meditating CGM in the Relationship between BIC and CP

In CG literature the constituents of CGM has been used as meditators in the relationship of different independent variable and CP. The important frameworks of CG, authored by (Forbes and Milliken, 1999; Nicholson and Kiel, 2004; Levrau and Van den Berghe, 2007; Ogbechie, 2012), are supported evidences of such meditating role of different components of CGM.

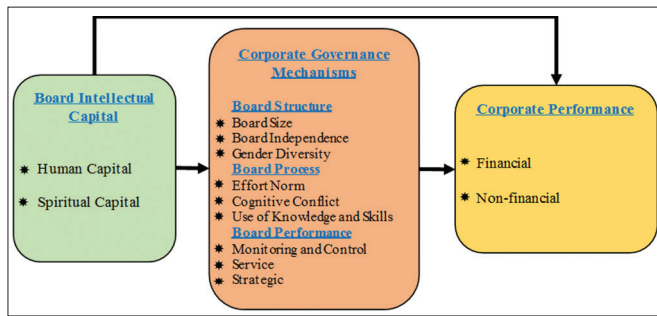
In their framework, Forbes and Milliken (1999) uses board processes (effect norms, cognitive conflict, and use of knowledge and skills), as mediator, which mediates the relationship of board characteristics (board demography, and presence of knowledge and skills), and board and firm level outcomes. Similarly, Nicholson and Kiel (2004)' framework uses board performance (controlling and organizing, and providing advice to management and resources), as meditators while establishing a relationship between BIC, and board and organization outcomes. The pervious framework by (Levrau and Van den Berghe, 2007) reported that the board process (debate or cognitive conflict) mediates the relationship of board structure (board size, board independence and board diversity) on board performance and CP.

Based on an input, process, output approach (Ogbechie, 2012) relied on premise that board characteristics of board size, leadership, independence, and diversity, and HC have influence on process of board decision-making, cohesiveness and administrative operations, which have significant impact on the effectiveness of boards. The authors distinguished board process and board performance constructs as intervening constructs with believe that they will mediate the direct impact of board characteristics on CP.

Hence, it's obvious from literature that prior to the current study all research efforts have assumed one or two components as mediators. This study hypothesis the whole CGM (board structure, board process and board performance) in a novel relationship of BIC and CP. Hence, following hypothesis are set for testing:

H6a: The BIC (HC) indirectly affects CP through its effect on board structure.

Figure 1: The proposed research framework



H6b: The BIC (HC) indirectly affects CP through its effect on board process.

H6c: The BIC (HC) indirectly affects CP through its effect on board performance.

H6d: The BIC (SpC) indirectly affects CP through its effect on board structure.

H6e: The BIC (SpC) indirectly affects CP through its effect on board process.

H6f: The BIC (SpC) indirectly affects CP through its effect on board performance.

2.5. Theoretical Framework

After critically reviewing the popular CG frameworks proposed by (Forbes and Milliken, 1999; Nicholson and Kiel, 2004; Levrau and Van den Berghe, 2007; Ogbechie, 2012), the current research endeavor has developed a holistic framework for examining how BIC (HC and SpC) affect CP through CGM (board structure, board process and board performance). The proposed research framework (Figure 1) takes a unique variables (board human and SpC) as input in order to determine the CP of a today's knowledge era firm. This model hypothesis a novel relationship between BIC and CGM.

In nutshell this research paper proposes an integrative theoretical framework which is based on the prior relevant research studies literature (Forbes and Milliken, 1999; Nicholson and Kiel, 2004; Levrau and Van den Berghe, 2007; Ogbechie, 2012). In addition, this study proposes research hypotheses which can be empirically and statistically tested by future research studies.

The current framework further assumes that CP is determined by the three constituents of CGM (board structure, board process and board performance) and mediation of CGM also add newness to this framework. To examine the interlinkages among various constructs and their dimensions in proposed conceptual framework would provide a meaningful insight into the CG research and body of knowledge and explore new relationships to developed hypotheses.

3. CONCLUSION

This research paper proposes on integrative research model of IG and CG. The previous research studies have frequently

reported that IC and CG is significantly impact on CP. CG boost up economic growth, reduces costs of capital, and influence stakeholder interest to increase CP. Researchers have argued that CG practices can reduce employees' conflicts of interest. This paper synthesizes the thinking arising from the review of previous literature and models of CG, and proposes an integrative research model. From the perspectives CG, this study argues that the new model should explore the relationship among BIC, CGM and CP.

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