DIRECTOR'S UNOBSERVABLE CHARACTERISTICS AND FIRM PERFORMANCE

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Abstract
This study examines the impact of Director's unobservable characteristics on firm performance. There has been an increase in interest among researchers on the observable characteristics of Directors, firm performance and firm value, believing that these characteristics do have an influence on a director's job effectiveness which translates to the success and value of a firm. It is however difficult to say the same for research studies concerning the unobservable characteristics of directors, firm performance and firm value, as there exist only a little body of work regarding the topic under spats'. It is on this premise that this study is carried out to decrypt the influence of director's unobservable characteristics on performance of firms which translates to the net worth of such firms (firm value). This study reveals after the review of extant literatures that the unobservable characteristic of directors such as expertise, interpersonal relationship and communication skills, emotions as well as commitment and loyalty influences a director's job performance, hence the value of the firm.

Keywords: Unobservable Characteristic, Emotions, Commitments, Expertise, Interpersonal Relationship and Communication Pattern, Director's Performance, Firm Performance and Firm Value.

1.0 Introduction

Firm value is transformation of a firm's shareholders' wealth. The value of a firm is the total net worth of what a firm owns usually summarized as the equity holdings of such firm. The human resource of any organization is an integral and vital organ of firm; it converts all other resources available to the firm into wealth. This process or action is what is known as productivity and efficient performance. It is on this burden that this study will analyze a firm's value in relation to performance using the unobservable characteristics of its directors. Firm performance is a relevant construct in management research and frequently used as a dependent variable. Despite this relevance, there is hardly a consensus about its definition; dimensionality and measurement. However performance is a measure of how much of the set objectives and goals of any group have been achieved.

The performance evaluation of a firm is not different, in that it is a measure of the achievability of a firm's objectives. In economics, a business's primary objective is to maximize profit as well as meet the needs of its stakeholders, with limited resources available to it. When viewed from this perspective, a firm's performance could be a measure of how a firm has harnessed the limited resources at its disposal to maximize profit, hence profitability and financial performance becomes a key measure of how well a firm is doing, and how well a firm is doing will determine the magnitude of its wealth.

The question of why some firms are successful and others are not (firm value) has been an area of interest amongst varied interest groups over time. Understanding the impact that a director's characteristics can have on a firm's performance is crucial to the overall financial performance of an organization. The underlying rationale is that both the observable and unobservable characteristics and attributes of directors would invariably translate to how effective they would be in the discharge of their duties, and sometimes these official duties can appear quite tedious, rather like those of a parent, quite emotional exerting (Thorn, 2007).

According to Chacha.com (2011), Unobservable behavior includes the mental & emotional activities & states that cannot be directly observed. These include emotional state, like anger, desire, happiness and volitional states like wanting to be noticed, intending to please. Also, cognitive states, like thinking about something or being confused or sensory experiences, like hearing and seeing. The focus of this study is mainly based on these unobservable characteristics of directors, its impact on their performance and the effects on the value of the firm.

The board of directors of a company are the pillars of a modern day company, as they been managers of other people's money rather than of their own (Smith, 2008). However, the incentive and ability of directors to safeguard shareholders interest can vary significantly among countries (Lel & Miller, 2015).

Board of director's performance is of key importance for the protection and maximization of shareholders' interests. Consequently, empirical studies related to the board of directors focus primarily on the performance function of the board of director (Adams, 2010). In most studies the performance function is related to observable board characteristics like the size of the board or the proportion of outside directors on the board. It contrast to this, prior research neglected the impact of unobservable characteristics of board directors on firm performance. Certain unobserved characteristics and attributes of these might have an impact on the management of the affairs of such companies. The performance of a board may be determined by unobservable characteristics of its individual directors (e.g. skill, commitment,

interpersonal relationship and pattern of communication, emotions, superior ability, expertise, reputation amongst others) that require the estimation of director performance, (Fernau, 2013). There is quite a rich body of both extant and empirical literature on the observable characteristics of board directors and its effects on firm performance (Herman & Weisbach, 2003; De Vries, 2007; Gordon, 2007; Pascal & Christophe, 2011; Fernau, 2013). These studies have specifically addressed gender or ethnicity issues yet they have mostly been silent on the real importance of characteristics such as expertise, skill, interpersonal relationship and pattern of communication as well as commitment that directors bring to the board, and these variables may be important in explaining why some firm are successful and why others are not (firm's value). Hence if such issues are omitted the findings from an investigation may not give a clear, comprehensive and true representation because important unobservable features of board directors have been left out.

Additionally, empirical studies do not often address issues on director's unobservable characteristics probably because detailed data of these characteristics is not readily available or due to difficulty to proxy (Bolli & Zurliden, 2009). It is in this light that this paper seeks to highlight the connection between Director's unobservable characteristics, its impact on performance and its effect on firm value as whatever affects the board of directors will affect their primary responsibility of directing, monitoring and supervision of the firm towards achieving its goals and objectives which primarily is to maximize shareholders wealth.

This study is of a conceptual nature, where the variables that interest us are director's expertise, skills, interpersonal relationship and communication pattern, commitment and emotions. Our objective is to analyze these variables in relation to director's effectiveness and then holistically a firm's value. The remaining part of this study is to review literature, define concepts in relation to firm value and draw conclusion from these reviews.

2.0 Literature Review

Conceptual Framework

Unobservable Characteristics and Directors Performance and Firm Value

Firm performance is the financial outcomes from a specified period of time as reported in the organization's Statement of Revenues and Expenses (Reio & Kidd, 2006). Gantenbein and Volonte (2011) opined that the prime responsibility of the board of directors is to monitor the management of an organization on behalf of the shareholders. The board advises the management and also has the power to make decisions. This director's power among other includes setting the firm's strategy and executive compensation, appointing the top management and nominating new directors. Since the board of directors is conferred with the responsibility of ensuring that the shareholders' money is not wasted, shareholder ought to have a serious interest in ensuring that board is staffed with well-educated and experienced directors that can give a high firm performance.

Many empirical literature exist which explores the determinants of firm performance. For example, Machin and Stewart (1990); McNabb and Whitfield (1998) and Munday, Peel and Taylor (2003) examine the determinants of financial performance, whilst Griliches and Regev (1995); Oulton (1998) and Griffiths and Simpson (2004) focus on the determinants of labour productivity. Many such studies are based on firm level data. One might argue, however, that, in order to understand the determinants of firm performance, it is important to also analyze the unobservable characteristic of directors. Hatch and Dyer (2004) discovered

that the value of human capital has its contribution to the competitive advantage of a firm as well increase the value of the firm.

Director's Expertise and Firm Value

The current global upsurge of corporate scandals caused concerned on the need for financial or accounting experts to be on board to ensure greater accountability on wide range of issue and as a result also enhance the firm's performance (John, Kaur & Cooper, 2015). For high performance in an organization, the firm's board needs to make certain that it has right and required mix of members with appropriate skills and experience to cope with business complexities, competition and changes.

In a study carried out by Wan-Yusoff and Armstrong (2012) in Malaysia on board competencies and firm performance using a quantitative approach, two stages Delphi technique. They found out that 8 competencies were of importance to the Malaysia companies based on personal interview with 41 participants and that the financial competency was more important compared to the others.

Davison et al. (2004) report that market valuation of a firm is positively related with appointment of a director with finance expertise on audit committee. Ghafran and O'Sulliva (2012) found that investors value the presence of audit committee and they perceive the appointment of expert director on audit committee positively.

Centered on the roles of the board bill, Iftechar and Qiang (2012) posit that during the global financial crisis, firms with high quality board experienced smaller losses than firms with low quality board. Financial experts on organizations board have received considerable attention from both the academic community and policymakers, and both of them have been broadly cited as one of the important indicators of board quality.

Directors Emotions and Firm Value

The emotional disposition of a company director could be translated to job effectiveness which could affect the firm's value through the decision made by the director. According to Robbins (2001), when directors feel happy about work related task then performance is increased and he/she carry out tasks in a better way. Brandt, Krawzyk and Kalinowski (2008) were of the opinion that there is a disagreement between employee personal life and performance. According to prawirosentoso (2000), performance is the outcome of work in an efficient way with considerable obligation for organization without interrupting any law and organizational goals. Mangkunegara (2005), says that performance of directors is the work consequence in excellence and the quality that is accomplished in carrying out his/her job functions. This excellence and quality can be influenced by the emotion or state of mind of the director. When looking at how emotion relate to job performance, a common research approach has been to explore pro social behaviors. Brief and Motowidlo (1986) noted that pro social behaviors should be important considerations for organizations as these behaviors contribute to organizational effectiveness.

Reio and Kidd (2006) used the Affective Events Theory in their study and described emotional impacts as how one feels on the job or one's emotional reactions to job events. Affective events theory proposed by Weiss and Cropanzano (1996), explains that a link between job affect and on-the-job-behaviors such as withdrawal or organizational citizenship behaviors. Bratton (2004) also noted that affective events theory provides a framework for understanding events that produce emotional responses in directors by suggesting that these

responses lead to long-term implications for an organization, including employees' attitudes, behaviors, and job performance.

Director's Interpersonal Relationship and Communication Skills and Firm Value

Interpersonal relationship and interpersonal communication pattern between the directors and the employees go a long way to improve a firm's performance and they both go hand in hand. According to Gabarro (1978), the process of communication and the form it takes are basic to how interpersonal relationships develop, grow or fail. He also argues that relationships are consequences of repeated communication and interactions among individuals.

The attainment of knowledge in today's competitive environment has proposed to occupy a central place in the development and sustainability of a firm's competitive advantage (Ambrosin & Bowmen, 2001). Many researchers are of the view that knowledge is a critical and intangible resource that has the ability to improve performance and a higher performance that is more sustainable over a long term (Zander & Kogut, 1995; Bresman, 1999; Gertler, 2001). Johnston (2005) explains that close interpersonal relationship between the director and the staff of an organization facilitates smooth communication and effective transfer of knowledge in that organization, which will also increase the firm performance.

Bowe, Holden and Lynch (2010), explained that the nature of the interpersonal relationship of directors has a positive impact on their communication patterns and in turn both have a positive influence on knowledge transfer efficiency which also has the ability to improve the performance of an organization. Having a strong interpersonal connection is believed to affect how easily knowledge is transferred from the directors to their subordinates or employees and also the more emotionally involved they are towards their staff and organization, the more time and effort they will be willing to put into the organization or on behalf of the organization (Reagans & McEvily, 2003).

Director's Commitment and Loyalty and Firm Value

Director's commitment and loyalty undoubtedly plays a vital role in the principal-agent issues surrounding the separation between the ownership and control of an organization. In today's world, due to globalization, there have been lots of prospects alongside different challenges for both global and local organizations as organizations now compete globally. Some global factors such as economic depression increase of production prices and limitation of resources has led to a constant increase in cost of manufacturing. This increase in prices is pushing corporations to adopt those ways through which cost can be minimized to survive in the competitive market (Ahmed, Komal, Javed & Hamad 2014). Organizational performance requires more personnel and new hiring, but satisfied, loyal and committed directors are true assets to any organization.

Instituting committed and loyal personnel may be associated with enhanced firm performance through less opportunistic behavior on the part of personnel (Green, 2008) or through influencing their supply of effort. Mowday, Steers, and Porter, (1982); Hunt and Morgan, (1994); Robbins and Coulter, (2003) explained that positive intention to serve an organization is being exhibited by its committed directors who are not thinking of quitting the organization. Buchann (1974) defined commitment as the emotional commitment to achieve the organizational objectives. It is the combined normative demands to perform in a manner which meets the organizational goals and objectives (Wiener 1982).

Meyer and Allen (2007) described organizational commitment as having three components; the first and second are normative commitment under which the directors commit to the organization because of feelings of obligation and continuance commitment whereby they commit because of the losses they will incur through leaving the organization. The third aspect is affective commitment, which concerns the employee's emotional attachment to the organization. Affective commitment is typically measured by asking among other things about an employee's feelings of loyalty to their organization or the extent to which they share the organization's values.

Kitchard and Strawser (2001) proposed that satisfied employees (directors) develop high affective commitment for their firm. According to Meyer and Allen (1991), affective commitment is the director's attachment to, identification with and involvement in the organization. Director's commitment and loyalty are fundamental in achieving a high performance in an organization; it is seen as a mediating factor between linking different types of human resources management and employment practices to enhance a firm's value (Brown, McHardly, McNabb & Taylor, 2011).

Martins and Jackson (2000) define director's commitment as the extent to which an employee stay with an organization and considers about organizational objectives seriously. Luthans and Fred (2006) described organizational commitment as the desire to be a member of an organization and not to complain about their organization.

Theoretical Framework

Affective Events Theory

Affect has been defined as how one feels on the job or one's emotional reaction to job events. Affective events theory, as postulated by Weiss and Cropanzano (1996), suggests a link between job affect and on-the-job behaviors. Bratton (2004) noted that affective events theory provides a framework for understanding events that produce emotional responses in employees by proposing that these reactions lead to long-term consequences for an organization, including employees' attitude, behaviors, and job performance. Using the affective theory, if then portends that the emotions of a director could have an effect on his/her job performance which translates to the how well/not well a firm does, as the firm value is a function of the director's effectiveness on the job.

Agency Theory

The principal-agent framework is used by Jensen and Meckling (1976) to clarify the conflict of interest between managers and shareholders. The agency problem as espoused by Jensen and Meckling (1976) is an essential part of the contractual view of the firm. Directors are contractual agents of the firm, and one of their primary functions is to monitor and direct the affairs of the firm. This function by the board is important because of the potential costs incurred when management pursue its own interest at the expenses of shareholders' interests.

Berle and Means (1932) assert that when ownership and control are separated (as they are in most modern firms), managers may pursue their self-interest at the expense of profit maximization, thereby creating "agency" costs. Monitoring by board of directors can reduce agency costs inherent in the separation of ownership and control and, in this way, improve firm value (Fama, 1980; Mizruchi, 1980: Zahra & Pearce, 1989).

3.0 Conclusion

The relationship between director's observable characteristics and firm's value has been investigated in many studies in the recent past and continues to gain in importance as a research topic. Prior studies related to the relationship of the board of directors rely on observable board characteristics and do not consider directors unobservable characteristics on firm performance and value.

From the review of literature on firms value and analysis of variables such as; Emotions, commitment and loyalty, expertise, interpersonal relationship and communications skills as unobservable characteristics of directors, The result of analysis from extant literature shows that the emotions of an individual could affect his/her level of job effectiveness which translates to the firm's performance and summarily firm value. The emotional disposition of a company's director could be translated to job effectiveness which could affect the firm's performance through the decisions made by the director. The emotional stability and the ability of a director to control his/her emotions is key to performance. It therefore means that the collective emotions of a company's directors will have an impact of firm performance and the value of the firm. Commitment and loyalty is an affective emotion that some directors have towards their firms, this allows them to have an emotional attachment with it. Here they see themselves as part of the firm and not just labourers in it. This form of commitment is what translates into job effectiveness and efficiency. This can account for why some firms are successful and why some are not, as a committed and loyal board of directors would surely drive performance and value creation than those who do not have any affective emotion towards it.

We also find that the level of expertise and skill of the board of directors is likely to be associated with their performance, as literature has shown that boards who have directors that are highly skilled in financial matters tend to survive during challenges than those with low financial skills and expertise

The human resource of any firm is a fundamental success instrument for that firm. The ability or inability to manage the employees of an organization can become the reason for its performance or non-performance. Interpersonal and communication skills seem to be an important construct in employees'/workers' productivity as shown from literature reviewed. It can be seen that the ability of a company's directors to effectively inter relate and communicate with employees, managers and stakeholders of the firms provides a clear directional and monitoring guide for the firm, hence this unobservable characteristics of a director is important to enable him/her deliver on the job.

Interestingly, the unobservable characteristics of directors and the impact on the directors, performance, and hence firm value is an area with great prospects in the field of research, as findings from such studies will better equip and enhance shareholders in the sourcing and decisions on whom to direct and monitor the affairs of the businesses and create wealth for it. It is our hope that this discussion awakens the interest of other researchers to carry out further studies on the subject matter.

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