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The Moderating Effect of Board Diversity on the Relationship Between Audit Committee Characteristics and Firm Performance in Oman: Empirical Study

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Abstract: This study aims to examine the relationship between audit committee characteristics and firm performance Oman. It also attempts to explore the moderating effect of the board diversity on the association between audit committee characteristics and firm performance and to fill the gap in the existing literature that examined the relationship between corporate governance and firm performance in the developing countries. The data is comprised of 162 non-financial companies listed on Muscat Security Market (MSM) through 2011 and 2012. This study used some assumptions in order to test independent variables, moderating variables and dependent variables as provided in the method section. This study revealed a positive association between audit committee size and audit committee meeting to firm performance but not significant. On the other hand, a negative but insignificant relationship was found between audit committee independence and firm performance. Moreover, this study revealed that the foreign members of the board have a significant moderating effect on the relationship between audit committee independence and firm performance. At the end, this study provides some future recommendations.

Key words: Corporate Governance · Audit Committee Characteristics · Board Diversity and Oman

INTRODUCTION

Recently, corporate governance has been taking the limelight, particularly after the collapse of huge corporations like Commerce Bank, Enron, WorldCom, Tyco among others [1, 2]. Similarly, the Sulatanate of Oman has also gone through its share of corporate troubles stemming from the financial crisis, affecting both large companies such as National Rice Mills SADGI and Omani National Investment Company Holding SAOG, as well as other several smaller companies which had to request for government assistance [3].

Corporate governance ensures the equal treatment of the entire shareholders with the inclusion of minorities and foreign shareholders. The former group needs protection from abusive actions or illegal direct or indirect control. Another corporate governance responsibility is the timely and accurate disclosure of information concerning the firm. Information should be prepared and disseminated according to high quality standards of accounting and financial as well as non-financial disclosure. Members of the board should base their actions on the right information, in good faith and with due diligence and care and in the best interests of the shareholders. It is the responsibility of the board to employ high ethical standards and to commit effectively commit to their responsibilities [4].

In addition, Cadbury describes CG as the mechanism utilized to provide discipline to the organizations and he added that it primarily handles the value creation of shareholders through the effective use of the assets of the firm. Similarly, Wolfensohn, the president of the World Bank, refers to CG as the promotion of corporate fairness, transparency and accountability. In a related study, [5] refers to CG as the complete set of legal, cultural and institutional arrangements determining the steps that public traded corporations take, who controls them and how they are controlled, how the risks and returns of the steps taken are allocated.

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As a matter of fact, it is important to note that audit committee size, audit committee independent and audit committee meeting presumably could continue to serve as corporate regulators to ensure management accountability and responsibility towards shareholders by ensuring that managers present true and fair view of the firms and avoid irregularities. Therefore, size, independence and meeting of the audit committee characteristics will serve as the blend of good corporate governance structure in creating firm's performance.

Moreover, the findings of empirical studies carried out in the US, UK, Chile, Israel, Hong Kong and other countries regarding firms' performance were found to be mixed while the study of corporate governance mechanisms in Omani listed companies are lacking. By carrying out this study, the findings may explain the level of the company's performance and the corporate governance in Oman. Moreover, this study was only one of the few studies in the gulf countries in general [6, 7, 8, 9, 10, 11,12] and the unique study in Oman in particular that elabores on the corporate governance and its impact on corporate performance in Oman [10].

The main objective of this study is to examine the influence of the corporate governance such as and audit committee characteristics (size, independence and meeting,) on firm performance (ROA) as dependent variable. On the other hand, it aims to investigate the board diversity moderating effect between corporate governance and firm performance (ROA) among Omani non-financial companies for two years. Based on our knowledge, this study is the first study to consider the moderating effect of board diversity on the relationship between the corporate governance and firm performance in Oman in an attempt to contribute to enriching the existing literature that studied the corporate governance and firm performance in developing countries, like the Gulf countries.

Literature Review and Hypotheses Development

Audit Committee Characteristics and Firm Performance: In the present section, the impact of three critical audit committee characteristics (ACC) factors upon performance is extensively discussed. Audit is the bridge that joins the communication network between auditors (internal and external). They are responsible for reviewing the nomination of auditors, the complete audit scope, the audit results, internal financial controls and financial information for publication [13].

Audit Committee Size and Firm Performance: With regards to the agency theory, the management-shareholders conflict often leads to top management's decision to serve their own interests and not the shareholders particularly when management is a very opportunistic person [14]. Therefore, audit committees that are efficient and effective must be able to resolve conflicts [15] and to work towards sustainable good performance [16, 17].

According to the resource dependence theory, the larger audit committee, the better will be the firm performance. A small audit committee does not possess the same diversity of skills and knowledge as its large counterpart and therefore, becomes ineffective [18, 19].

There are widely researches that found a negative relationship between audit committee size and firm performance in the developed countries [20] and however, there is limited studies that confirmed the negative association between them [9, 21]. On the other hand, some studies conducted in developed countries examined the relationship between audit committee size and firm performance and found it to be positive [22,2 3, 24]. Similar findings were found in some developing countries [9, 25, 26].

Apart from the agency theory and resource dependence theory, some studies that found no relationship between the audit committee and firm performance such as [27, 11, 28, 29]. Based on the past literature regarding their relationships, the following hypotheses are formulated:

H_1: There is a relationship between audit committee size and ROA

Audit Committee Independence and Firm Performance: Audit committee characterized by a higher member of non-executive directors are considered to be more independent compared to those with more executive directors [17]. Similarly, external audit committee members have a key role in making sure that the practices of corporate governance in auditing processes [26].

From the perspective of both the agency theory and resource dependence theory, the autonomy given provides the opportunity to reach the right decision without any restriction and to detect errors and reveal them without any problems because the independent reviewers are not related to the company. The relationship between audit committee independence and firm performance is expected to be positive. However, there are very little studies that have examined the relationship between audit committee independence and firm performance both in the developed nations [31, 23] or the developing countries [29, 30, 26]. They found a positive association between the audit committee independence and firm performance.

Similarly, few researchers also found a negative association between the audit committee independence and the firm performance [32]. In the end, there are some researchers who found adverse results in prior outcome and revealed no relationship between audit committee independence and firm performance such as, [9,1 0, 11, 33, 34]. In light of the previous arguments and other supporting ones, the following hypotheses are proposed.

H_2: There is a positive relationship between audit committee independence and ROA.

Audit Committee Meeting and Firm Performance: From another perspective, under agency theory, [35] suggested that boards should be relatively inactive and evidence of higher board activity is likely to symbolize a response to poor performance. Similar, [36, 37] suggested that greater frequency of meetings is likely to result in superior performance.

In general, a thorough review the current literature showed that there is no clear-cut relationship between the board meeting and firm performance. There are few researchers that have investigating this association and found a positive relationship between the audit committee meeting and firm performance in developed countries, for example [23] and in the developing countries [38, 39, 40]. On the other hand, [21] found a negative relationship between the audit committee meeting and firm performance.

From another perspective apart from the two theories, no association was found between audit committee meeting and firm performance; for instance, [9, 10, 28]. Based on the conflict evident between the theories and past evidence, the results are still conclusive. Hence, the following hypotheses are formulated:

H_3: There is a relationship between audit committee meeting and ROA.

The Moderating Effect of the Board Diversity on the relationship between Corporate Governance and Firm Performance: According to some researchers, diversity results in a more expansive knowledge base, creativity and innovation and hence becomes a firm's competitive advantage [41,42]. Other researches dedicated to board structure examine the direct association among race, board directors and firm performance. However, the inconsistent findings between board of directors and firm performance is associated with the lack of moderating variables [43] and as such, the present study attempts to fill the gap and provide an insight into these moderating variables.

More importantly, according to the resource based theory, board diversity may be a source of competitive advantage for a firm [44,45], as it is more effective in observing opportunities and threats in several facets and possesses a more expansive array of skills and capabilities for solving issues and making decisions [46].

Therefore, the present study will be unique in that it investigates the relationship between the less visible diversity and non-observable diversity as moderators between board structure and firm performance. Since, there little research has examined that the relationship between board diversity and firm performance explained in detail in the coming paragraphs.

Foreign Members Serving on the Board and Firm Performance: Foreign directors bring with them invaluable knowledge concerning contextual issues in foreign markets and hence they contribute to the strategic decision making quality [47]. They are also less likely to be associated with firms and its management and are therefore independent [48]. Furthermore, foreign directors may bring much needed expertise and diversity, especially for companies that operate globally.

On the contrary, foreign directors are inherently costly -they may come from a different culture, speak a different language, be physically distant from the companies on whose boards they serve and may demand a higher level of compensation for the inconvenience of serving on boards outside their own country of residence.

Although the importance of this variable is clear, there is lack and little previous study examining this relationship. Following the recommendation of [10, 39], the current study covers this gap by providing a clear insight about it. And hence, the current study investigates this issue to investigate the corporate governance-firm performance association.This study was contributing to literature by testing the following hypotheses.

H_{4a}: The foreign members serving in the board moderate the relationship between the size of the board directors and ROA.

H_{4b}: The foreign members serving in the board moderate the relationship between the board composition and ROA.

H_{4c}: The foreign members serving in the board moderate the relationship between the board meeting and ROA.

The Commitment effect of the Board and Firm Performance: To attend the meeting indicates the seriousness of work and to assess the problems first hand and work to resolve them in order to make good decisions that will help to achieve the objectives of the entity and investors. In the same context, the regular timeliness of the work facilitates investors' confidence in the company because commitment demonstrates hard work and outstanding efforts in order to raise the value of the company and attract new investors. The commitment shows the seriousness, monitoring, evaluation, prominence, excellence in order to raise the value of the business and investors as one [49].

Regarding the agency theory, the separation of jobs gives the independence to make the right decisions. It brings monitoring and evaluation of firms and integrity to reports for all interested with the firm without keeping any information secret [14]. Generally speaking, the commitment of the board indicates all the members' obligation to improve performance for firms [50].

Given the importance of commitment, the lack of commitment of all board structure and ignorance of the procedures, tasks and responsibilities come as a surprise. [51, 52,53, 54] they recommended studying board diversity with firm performance such as the commitment of the board. The current study examines commitment of the board as a moderating variable in all board structure. The present study examines board diversity's impact on the corporate governance and firm performance relationship by testing the hypotheses.

H_{5a}: The commitment of the board moderates the relationship between the size of the board directors and ROA.

H_{6b}: The commitment of the board moderates the relationship between the board composition and ROA.

H_{6c}: The commitment of the board moderates the relationship between the board meeting and ROA.

Research Method and the Study Models: There is a total of 169 firms listed in the Muscat Securities market (MSM), categorized into groups based on their commonalities. The population of this study comprises of non-financial firms category from the list (http://www.msm.gov.om/). Accordingly, there are 81 non-financial firms listed on the main board and secondary board since 20th September 2012. The present study sample selected all 81 non-financial firms and excluded financial ones.

$$ROA=\alpha 0+\beta 1*ACSIZE+\beta 2*ACINDE+\beta 3*ACMEETIN+\beta 4*FIRMSIZE+\beta 5*LEVERAG+\varepsilon \quad (1)$$

$$ROA=\alpha 0+\square 1*ACSIZE+\square 2*ACINDE+\square 3*ACMEETIN+\square 4*BO\_FORE+\square 7BO\_COM+\square 5*BO\_FORE*ACSIZE+\square 6*BO\_FORE*ACINDE+\square 7*BO\_FORE*ACMEETIN+\square 8*BO\_COM*ACSIZE+\square 9*BO\_COM*ACINDE+\square 10*BO\_COM*ACMEETIN+\square 11*FIRMSIZE+\square 12*LEVERAG+\varepsilon \quad (2)$$

Data Analysiz and Results

Descriptive Statistic

Correlation Analysis

Regression Results Based On Accounting Measure

Hierarchical Multiple Linear Regression Results: The use of board diversity (foreign board member and board commitment) as a moderating variable is justified by the attempt to contribute new knowledge to literature. As such, the moderating role of board diversity (foreign board member and board commitment) on the board directors' characteristics- firm performance relationship is examined.

Steps were followed to examine the control variables followed by the estimation of the un-moderated equation and the moderated equation. Statistically, the R2 change is consistent with the moderating effect [55]. In cases where the variable is a moderating variable, a post-hoc graph is created to predict the influence of the moderator on the relationship between the predictor and criterion variables. This study is employed to achieve the third objective of the study, which is to determine whether or not board diversity (foreign member and board commitment) influence the board of directors characteristics (board size, board independence and board meeting) – firm performance (ROA) relationship.

The employment of regression analysis on the moderating effect is discussed in the following sub-sections. The results of the hierarchical multiple regression analysis are also provided in the coming sections through the four models as presented in Table 6.

Step 1: In this model, the firm size and leverage are entered as a control variable into the regression model in the first step, with coefficient of determination F-value (27.383) and F Sig (0.000). This model found (R2) to be 0.256, indicating that 25.6 % of the firm performance (ROA) can be explained by the firm size and leverage with

Significant F change of 0.000. The result in Table 6 showed that the firm size (FIRMSIZE) was found to be positively significant with ROA with the indicators (β=0.230, t=3.361, p>0.1). On the other hand, Table 6 shows a negatively significant relationship between leverage and ROA with the indicators (β=-0.437, t=-6.372, p>0.1).

Step 2: In this model, the three audit committee characteristics (size, independence and meeting) were introduced to the model. This model was found to be significant (F=10.842, p<0.01) with adjusted R2 as 23 per cent and significant F change at the 0.01 level of significance. The results in Table 6 show that he firm size (FIRMSIZE) was found to be positively significant with ROA with the indicators (β=0.221, t=3.078, p>0.01). On the other hand, Table 6 shows a negatively significant relationship between leverage and ROA with the indicators (β=-0.436, t=-6.302, p>0.01). Finally, audit committee size, audit committee independence and audit committee meeting were found to have insignificant effect on ROA with indicators (β= 0.005, t= 0.068, p>0.1, β= -0.017, t= -0.241, p>0.1, β= 0.040, t= 0.558, p>0.1) respectively.

Step 3: In this model, foreign member on the committee (AC_FORE) and board commitment (AC_COM) were introduced to examine its predictive power toward firm performance (ROA). This model was found to be significant (F=8.016, p<0.01) with adjusted R^2 of 26.7 per cent. Even though the model showed significance at the 0.01 level, it did not improve the explanatory power of the model since the R^2 change was not significant (R^2 change=0.009, p<0.1). Furthermore, this model accounted for 24.2 per cent of the variance in the model.

The results in Table 5 show that firm size was found to have a strong positive effect on firm performance (ROA) with the indicators (β= 0.213, t= 2.933, p<0.01). Moreover, the leverage also found to have a strong negative effect on firm performance (ROA) with the indicators (β= -0.446, t= -6.341, p<0.001). on the other hand, audit committee size, audit committee independence, audit committee meeting, the foreign member on the committee and the commitment of committee were found to have a insignificant relationship with ROA with the indicators (β= 0.007, t= 0.095, p>0.05), (β= -0.019, t= -0.277, p<0.05), (β= 0.048, t= 0.669, p<0.05), (β= 0.011, t= 0.148, p<0.05) and (β=-0.094, t= -1.342, p<0.05) respectively.

Step 4: In this model, the interaction terms between board diversity (foreign member on the board and board commitment) and audit committee (size, independence and meeting) were examined to test the moderating effects in this study. This model was reported to be significant at the 0.01 level of significance (F=4.642, p<0.05). However, this model found to be insignificant (R2 change= 0.023, p> 0.1). The result in Table 5 showed that firm size was found to have a strong positive effect on firm performance (ROA) with the indicators (β= 0.238, t= 3.114, p<0.01). Otherwise, the leverage also found to have a strong negative effect on firm performance (ROA) with the indicators (β= -0.454, t= -6.283, p<0.001). An insignificant relationship were revealed between audit committee size, audit committee independence, audit committee meeting, foreign member on committee and the commitment committee to ROA with the indicators (β= 0.012, t= 0.168, p<0.05), (β= 0.023, t= 0.307, p<0.05) ,(β= 0.038, t= 0.457, p<0.05), (β= -0.004, t= -0.049, p<0.05) and (β= -0.057, t= -0.741, p<0.05) respectively.

The results regarding the interaction terms reveals that only one relationship in the model was significantly moderated by board diversity. Specifically, the interaction term between the foreign member on the committee and audit committee independence was significant at the 0.01 level of significance (β= 0.138, t= 1.759, p>0.05). These results indicate that foreign member on the committee positively moderates the relationship between audit committee independence and firm performance (ROA).

RESULTS AND DISCUSSION

In this section, this study provides the results related to the relationship between audit committee characteristics and ROA and the findings of the moderating effect of board diversity on the relationship between audit committee characteristics and ROA.

The result found a positive but not significant association between audit committee size and ROA. A probable reason for insignificant finding of audit committee size and ROA is that in the context of Oman, an audit committee is not as important as it is in developed countries. Moreover, this study found a negative but not significant relationship between audit committee independence and ROA. A possible reason for this insignificant result of audit committee independence is that the sole existence of audit committee independence on the board may be insufficient for audit committee to achieve its monitoring responsibilities to enhance firm's value.

Table 1: Summary of Variables Measurement

N0	Variables	Acronym	Operationalisation
Dependent Variables (DV)			
1	Return On Assets ratio (%)	ROA	Earnings before tax divided by total assets of the company.
Independent Variables (IV)			
2	Audit Committee Size (number)	ACSIZE	Number of members serving on the audit committee.
3	Audit Committee Independence (%)	ACINDE	Number of non-executive members serving on the audit committee.
4	Audit Committee Meeting (number)	ACMEETIN	The frequency number of meetings during a year for the audit committee.
Moderators Variables (MV)			
5	The Foreign Member on the Committee(number)	AC_FORE	The number of non-executive foreign directors divided by the total number of committee members.
6	The Commitment of attendance (ratio)	AC_COM	The commitment of the committee is measured by the attendee of the meeting. It meant by ratio of attendance for all the members during a year.
Control Variables (CV)			
7	Firm Size (number)	FIRMSIZE	The natural log of total assets.
8	Leverage (%)	LEVERAG	The ratio of total liabilities to total assets.

Table 2: Descriptive Statistics of Continuous Variables

Variables	Unit	Mean	Std. Deviation	Min	Max
Audit Committee Size (ACSIZE)	Number	3.52	0.72	3.00	7.00
Audit Committee Independence (ACINDE)	Ratio	0.93	0.19	0.00	1.00
Audit Committee Meeting (ACMEETIN)	Number	4.74	1.28	0.00	9.00
Foreign Member (AC_FORE)	Ratio	0.3162	0.33604	0.00	1.00
Board Commitment (AC_COM)	Ratio	0.8223	0.22167	0.00	1.00
FIRM SIZE (FIRMSIZE)	OR	62979251.03	125657047.90	605320.00	685377000.00
LEVERAGE (LEVERAG)	Ratio	0.49	0.28	0.02	1.72
Return On Assets (ROA)	Ratio	0.06	0.10	-0.34	0.32

Table 4: Results of Pearson Correlation Analysis

	1	2	3	4	5	6	7	8
1) ACSIZE								
2) ACINDE	0.137*							
3) ACMEETIN	0.127	0.112						
4) AC-FORE	-0.046	0.059	-0.093					
5) AC-COMME	0.011	-0.008	0.061	-0.173***				
6) FIRMSIZE	0.194**	0.020	.217***	0.078	-0.052			
7) LEVERAG	-0.059	-.015	-0.028	0.161***	-0.082	-0.062		
8) ROA	0.076	-.001	0.099	-0.034	-0.067	0.257**	-0.451***	

Notes:
***Correlation is significant at the 0.01 level (2- tailed).
**Correlation is significant at the 0.05 level (2- tailed).
*Correlation is significant at the 0.1 level (2- tailed).

Table 5: Regression Results of Model (Dependent= ROA)

	Standardized Coefficients		
Variables	Beta	t-value	Sig.
Audit Committee Size (ACSIZE)	0.005	0.068	0.946
Audit Committee Independence (ACINDE)	-0.017	-0.241	0.810
Audit Committee Meeting (ACMEETIN)	0.040	0.558	0.578
FIRM SIZE (FIRMSIZE)	0.221	3.078	0.002
LEVERAGE (LEVERAG)	-0.436	-6.302	0.000
R2			0.258
Adjusted R2			0.234
F-value			10.842
F-Significant			0.000
Durbin Watson statistics			1.923

Table 6.14: The Moderating Effect of the Board Diversity on the Relationship Board Directs Characteristic and ROA

	Step 1 Control variable			Step 2 Without interaction			Step 3 Moderator variable			Step 4 With interaction		
Variables	Beta	T	Sig.	Beta	T	Sig.	Beta	T	Sig.	Beta	T	Sig.
FIRMSIZE	0.230	3.361	0.001	0.221	3.078	0.002	0.213	2.933	0.004	0.238	3.114	0.002
LEVERAG	-0.437	-6.372	0.000	-0.436	-6.302	0.000	-0.446	-6.341	0.000	-0.454	-6.283	0.000
ACSIZE				0.005	0.068	0.946	0.007	0.095	0.925	0.012	0.168	0.867
ACINDE				-0.017	-0.241	0.810	-0.019	-0.277	0.782	0.023	0.307	0.759
ACMEETIN				0.040	0.558	0.578	0.048	0.669	0.504	0.038	0.457	0.648
AC_FORE							0.011	0.148	0.883	-0.004	-0.049	0.961
AC_COM							-0.094	-1.342	0.181	-0.057	-0.741	0.460
ACS_FORE										-0.008	-0.112	0.911
ACI_FORE										0.138	1.759	0.081
ACM_FORE										0.023	0.276	0.783
ACS_COM										-0.063	-0.861	0.391
ACI_COM										-0.111	-1.220	0.224
ACM_COM										0.034	0.380	0.705
F value	27.383			10.842			8.016			4.642		
F Sig.	0.000			0.000			0.000			0.000		
R2	0.256			0.258			0.267			0.290		
Adjusted R2	0.247			0.234			0.234			0.227		
R2change	0.256			0.002			0.009			0.023		
Significant F change	0.000			0.950			0.384			0.583		
Durbin Watson												1.923

Along the same path, this study found no relationship between audit committee meeting and ROA. A possible reason for insignificant finding of audit committee meeting and ROA is that according to [36, 37], the more frequent the meetings are, the more likely they will lead to superior performance of the firm. The reason behind the insignificant moderating effect of foreign members on the committee with regards to the relationship between audit committee characteristics (size and meeting) and ROA is that foreign member may not be as knowledgeable when it concerns the current environment and how to make decisions with limited information gathered.Moreover, the result found insignificant moderating effect of the committee commitment on the relationship between audit committee characteristics (size, independence and meeting) and ROA. This insignificant moderating impact may be attributed to inefficient board sizes which often fail to do efficient work due to under qualified and inexperience members and their inability to deal with the new environment.

CONCLUSION

As mentioned earlier, this study attempted to achieve several objectives; first, it aims to investigate the relationship between audit committee characteristics and firm performance in an emerging market, Oman. Second, it aims to explore the moderating effect of the board diversity on the association between audit committee and ROA. Third, it attempts to present a clear picture on the current situation of corporate governance on Oman. The results found direct insignificant association between audit committee characteristics and ROA. Moreover, an insignificant moderating effect of foreign members was revealed on the relationship between audit committee characteristics and ROA. The data used comprises of 162 non-financial for two years (2011 and 2012). This study used multiple regression and hierarchical multiple regression to analyze the relationship between independent and moderating variables and dependent variables.

This study, as with prior studies, has some recommendations for future studies. Future researches should extend the sample for many years and should include financial companies. Moreover, they should examine other variables such as, board of directors characteristic, ownership structure and others. This study recommends future research to add other main variables to board diversity such as experience and qualification and to examine the relationship again in this context.

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