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Research on Corporate Strategy and Financial Performance Based on Board Function

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ABSTRACT
The board of directors, as a "central" institution connecting shareholders and managers, is the final decision maker of the corporation, and the core of corporate governance. The legislation of each country and the guidelines of various institutions regard the construction of an efficient board of directors as the goal of corporate governance. This paper discusses the impact of board governance on financial performance, the impact of board functional structure on diversification strategy, the impact of diversification strategy on financial performance, and the mediating role of diversification strategy on executive motivation and financial performance from the perspective of diversification strategy implementation, combining relevant theories and scholars' perspectives.

Keywords: *Board Governance, Corporate Governance, Financial Performance, Diversification Strategy*

1. INTRODUCTION

With the development of modern corporation system in China, the corporate governance structure has gradually become the core of modern corporation management and operation, which plays a decisive role in the corporation's financial performance[1]. The board of directors, as the "central" institution connecting shareholders and managers, is the final decision maker of the corporation whose has the ultimate control. The characteristics of the board of directors are a key influence on governance performance. The characteristics of the board of directors affect governance performance by influencing the performance of the board of directors. Therefore, it is of great significance to explore the relationship between corporate strategy and financial performance based on the functions of the board of directors for improving the governance performance of the board of directors. Based on the principal-agent theory, the starting point and end point of corporate governance focus on how to improve the operating performance of listed companies and maximize the interests of shareholders. This paper will conduct a comprehensive and systematic analysis of the framework dimension of corporate governance mechanism——the mechanism of board governance structure's effect on corporate financial performance, laying a solid foundation for the subsequent empirical research.

2. THEORY APPLICATION

2.1. Corporate Governance and Diversification Strategy

After World War II, large companies took diversification as their main method of expansion. In the 1960s and 1970s, the third wave of merger and acquisition broke out in the United States. Many large companies generally adopted the way of merger to carry out diversified operation, leading a trend of diversified operation. The advantages of the diversification strategy are to diversify external risks, save transaction costs, facilitate internal cooperation and improve operational efficiency. Industrial economics, finance, strategic management, organizational theory and other disciplines have conducted in-depth research on this topic from multiple perspectives. However, since the 1990s, China's domestic corporations began to implement the diversification strategy. This part reviews the literature on diversification strategy at home and abroad.

2.1.1. Motivation of diversification strategy

Ansoff believed that corporations carry out diversification in order to gain growth, resist risks and achieve business cooperation[2]. However, these views are not comprehensive enough. Corporation diversification motivation is the factor that drives corporations to implement diversification strategy. Scholars have studied diversification strategy motivation from different disciplines and obtained fruitful results. All kinds of theoretical explanations can be summarized as follows: first, the external environment in which the corporation operates——the market and institutional environment. The corresponding theories include market competition theory and institutional basic theory. Second, the internal characteristics of corporations, the corresponding theories are diversified agency theory, resource-based theory etc. As China is at an important moment of market economy transformation, the small and medium-sized corporations listed in gem in China also have their special motivation in terms of diversification strategy.

2.1.2. Diversification strategy classification

Researchers have sorted out and classified the types of diversification strategies, which can be summarized as follows. Rumelt evaluation method, Product-Market Strategy, corporation development model category, etc. To begin with, we define a few key concepts: the specialization ratio (SR), which refers to the proportion of the total sales revenue of the corporation in a year that is the largest single business of the corporation. Market classification ratio (CR). CR is the largest market category in the corporation. For example, the income from industrial products and consumer goods accounts for the proportion of the total sales revenue of the whole corporation. Associated ratio (RR) refers to the proportion of the sales revenue of the largest relevant business group of the corporation in the total sales revenue of the whole corporation in a year. Vertical integration ratio (VR), VR refers to the proportion of the total revenue from the largest vertical production that accounts for the total sales revenue of the whole corporation. Product ratio (PR), PR is the proportion of the revenue of the largest product group in the total sales revenue of the whole corporation. Core correlation ratio (RC). RC refers to the proportion of the revenue from the largest business group with common core skills to the total sales revenue of the whole corporation.

2.2. The Corporation's Financial Performance and evaluation methods

As a profit organization, corporations provide products or services to customers through its manufacturing operations. There is no uniform definition of corporation performance in academic circles. Corporate performance generally includes the profitability, development ability and comprehensive competitiveness of a corporation, etc. In recent years, Tobin's Q value, EVA, MUA and the comprehensive index system established by the balanced scorecard have all given different connotations to corporate performance. It is not the intention of this paper to strictly define corporation performance, but rather to reflect the business results of corporations as comprehensively as possible. The measurement of corporation performance can be roughly divided into two categories, namely, financial performance evaluation and market performance evaluation. Because market evaluation is easily affected by market cycles and other factors, this paper intends to take financial performance evaluation as the most basic evaluation data.

2.3. The Corporation's Financial Performance and Evaluation Methods

2.3.1. Influence of board governance on financial performance

Some foreign scholars have conducted relevant studies on the functional background of the board of directors. According to different functional backgrounds, they made different classifications and studied the influence of independent directors or outside directors with different functional backgrounds on corporate performance. Brickley, Coles & Terry, according to functional backgrounds, divide the outside directors into four categories: (1) Managers of other companies who have no extensive business connections with the corporation; (2)Private investors; (3) educators, government officials and religious figures; (4) Professional director. They studied a sample of 247 companies from 1984 to 1986 and found that professional directors had the most significant explanatory ability[3]. Roscnstein & Wyatt classified the outside directors into corporation outside directors, financial outside directors and neutral outside directors[4]. The results show that the corporation outside directors has no significant confidence and cannot decide which type of outside director is more valuable than the other two types. Therefore, this paper also takes the functional background of the board of directors into the dimension index of examining the governance status of the board of directors.

2.3.2. Diversification strategy classification

Based on the agency theory and the empirical research of "diversification discount", scholars have done a lot of researches on how to strengthen the functions of the board of directors to constrain the diversification decisions of controlling shareholders and managers. Baysinger and Hoskisson think internal directors can effectively influence the strategic direction of the corporation. If the information provided by outside directors lack the share of internal directors, they will have to rely on the financial performance indicators to evaluate effectiveness and the CEO's, which could lead to a CEO support diversification strategy which has low risk but do harm to the interests of the shareholders[5]. Internal directors can make more effective evaluation on the quality of CEO's strategic decisions due to their daily contact with CEO, and can provide reasonable compensation for high-risk but reasonable strategic decisions. Studies have shown that boards dominated by outside directors are more likely to adopt diversification strategies.

Li Cheng used the sample data of 879 companies in 2002 to study the effects of board characteristics on corporate diversification [6]. Kruskal Wallis nonparametric test results show that the scale of the board of directors, the joining together of two job status and the proportion of independent directors with the business unit number, diversified related degree, sales HeFen del index and office value measure the degree of diversification does not exist any relationship, so as to think that the efficiency of board governance.

The research of Wei Feng and Xue Fei shows that the frequency of board meetings, the proportion of independent directors and the combination of two positions are significantly positively correlated with the diversification decision, and the shareholding ratio of directors is negatively correlated with the probability of diversification [7]. The further explanation is that the frequency of board meetings and the proportion of independent directors are the main factors that affect the decision-making of diversified corporations and thus the performance of diversified corporations.

Xue Youzhi and Zhou Jie also investigated the value effect under the board structure from the perspectives of diversified decision making and diversified operation manager [8]. Empirical study results show that improving the proportion of independent directors does not play an important role in supervision and control management. On the contrary, the improvement of ratio of independent directors improve the negative effect to the corporation value on the diversified operation. There is difference between the optimal number of the board of directors of diversity level and the optimal number of the board of directors of operation level. The separation of the board of directors and general manager cannot effectively restrain the non-scientific decision-making and exert a positive effect on the value effect of diversified operation.

2.3.3. Functions of the board of directors and strategic participation of the corporation

At present, the academic circles put forward different opinions on the role of the board of directors in corporation strategic management based on different theoretical perspectives.

Researchers represented by the agency theory tend to hold a negative attitude towards the possibility of strategic participation in the board of directors' control function because they mainly emphasize the play of the board of directors' control function. The modern housekeeper raised doubts about the Human nature hypothesis of managers and indicates that there is not the opposite relationship between the board of directors and managers, but a relationship of mutual trust and cooperation. By increasing the size and diversity of the board of directors, companies can reduce transaction costs by strengthening mutually beneficial connections and cooperation between organizations, and the board can effectively enhance the corporation's ability to access critical resources and strategic information. Therefore, from the perspective of principal-agent theory, housekeeper theory and resource dependence theory, the cognitive difference of the board of directors on the degree of strategic participation is the fundamental reason for the cognitive difference of the board of directors on the performance of strategic functions.

In recent years, Chinese scholars have begun to explore the potential significance of board of directors for corporate strategic management from different perspectives. Wang Yuetang et al. discussed the potential strategic significance of the reputation mechanism, industry expertise, political relations and economic management background of independent directors for corporations under the background of China's current special system. Wei Gang et al. also discussed the importance of independent directors for corporations to obtain external resources to support their growth from their "label background" (educational background, working background and industry experience, etc.). Gong Hong, Ning Xiangdong and Cui Tao believe that, as the top strategic decision-making organ of a corporation, the board of directors has roles which are usually limited to decision-making, Suggestions and approval [9]. How to effectively improve and expand the strategic functions of the board of directors and ensure the effectiveness of the entire strategic process of the corporation has become the key to improve the functions of the board of directors.

3. MODEL

Based on the definition and dimension division of the above variables, combined with the relevant theoretical research of scholars around the world and the realistic situation of the development of listed companies on gem in China, it can be concluded that corporate governance can be regarded as a relationship between various stakeholders who decide and control the strategic direction and performance of corporations.

Corporate governance has a great impact on corporate financial performance, and it is also the determinant of corporate strategic choice. Zhao Lin's research shows that the board of directors contributes to innovation, shareholder wealth and social responsibility, and bankruptcy risk avoidance through strategic behaviors. Diversification strategy is an important strategy for the development of corporations, and also has an important impact on the financial performance of corporations. Adrian li research has shown that the complexity of the diversification strategy implementation increase the corporation internal and external information asymmetry degree, and the more important is to reduce the equity incentive and positive role in promoting the incentive mechanism of salary incentive, etc, thus strengthening the control functions in the process of diversification strategy implementation has become an important means to reduce managers agency costs. Becker and Huselid have proposed a kind of thought: Corporate governance plays a role in business results through strategy implementation, and strategy implementation ability is an intermediary variable affecting corporate governance level on corporate performance [10]. Therefore, there is a potential relationship between corporate governance, diversification strategy and financial performance. Gem listed companies have their own characteristics in terms of governance structure, diversification strategy and financial performance. However, most corporations are in the important stage of development and growth, so implementing the diversification strategy is not only an urgent matter, but also an inevitable choice. At present, it is necessary to conduct in-depth research on how the corporate governance of gem listed companies will influence the diversification strategy and how to obtain financial performance.

Taking gem listed companies as the research object, the relationship between corporate governance, diversification strategy and financial performance is further studied to enrich corporate governance theory and improve diversification strategy theory. It is of theoretical significance and practical value for corporations to effectively formulate and implement diversification strategies and provide decision basis and Suggestions, to improve their financial performance.

The theoretical model is mainly composed of three parts: "corporate governance" reflects the corporate governance structure and mechanism; "financial performance" reflects the implementation effect of corporate diversification strategy; and "diversification strategy" represents the current cross-industry and business operation state of the corporation. Specifically, this model mainly reflects four kinds of logical relations. Several logical relations are explained as follows:

1. The influence mechanism of board governance on financial performance.

2. The influence mechanism of board governance on diversification strategy.

3. The impact of diversification strategy on financial performance. This paper mainly studies the relationship between diversification strategy degree and various indicators of financial performance.

4. The mediating effect of diversification strategy on the relationship between corporate governance and financial performance. This paper mainly studies the mediating effect of diversification strategy on board governance and financial performance.

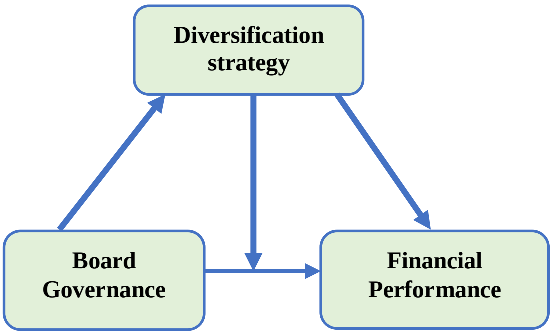

Figure 1 Relationship among Board Governance, Diversification Strategy, and Financial Performance

4. RESULTS

4.1. Discussion on the Impact of Board Governance on Financial Performance

Contingency theory points out that there is a complex relationship between board heterogeneity and corporation performance, because some factors of heterogeneity of the board of directors may be desirable within the organization, but the difference of time and environment should also be taken into account. The heterogeneity of board members' backgrounds and corporate strategy are usually regulated by different organizational situational factors. Therefore, the relationship between the heterogeneity of board members' backgrounds and corporate performance should be considered from the perspective of contingency.

When the proportion of functional background of the board of directors is no more than 52.7%, study of Zhang thinks that because of the expansion of information and the complex degree of deepening, in a short period of time to optimize integration may cause internal conflict, which results the board of directors difficult to communicate with, and hard to build the boardroom commitment. When proportion of functional background of the board of directors exceeds 52.7%, based on the decision-making theory, internal members thinking flexibility increases. It can be concluded that the functional structure of directors is related to financial performance in a "U-shaped" way.

4.2. Discussion on the Influence of the Functional Structure of the Board of Directors on the Diversification Strategy of the Corporation

First of all, the heterogeneity of the functional backgrounds of board members is reflected in the different types of functions undertaken by team members before they enter the corporation, as well as the degree of mastery of professional and technical knowledge within the team. The functional experience of an individual prior to joining a corporation is closely related to the degree to which he or she participates in corporate governance decisions, as this usually reflects the individual's perception of problems and problem-solving characteristics. Tuggle pointed out that the heterogeneous functional background could enhance the constructive discussion degree of the board of directors on the strategic decisions of the corporation, so that the board members could consider the innovation and diversification strategy of the corporation more comprehensively and rationally, which inhibited the generation of diversification strategy to some extent.

Second, various experts will naturally analyze related issues in this field from different angles according to his own situation. Most of board of directors with high technical ability of the would stick to the correctness of the existing views, thus enables the team conflict more likely, which results in the decrease in the effectiveness of the team.

Finally, for China's GEM listed companies, their operating market environment is highly dynamic and complex. With the increase of the proportion of the functional background of the board of directors, the heterogeneity of team resources will be caused. At the same time, mutual distrust and potential conflicts among the members of the board of directors are not conducive to the implementation of scientific and reasonable strategic decision-making and strategic innovation. At the same time, with the expansion of the board of directors, each director of mutual coordination and communication complexity increases accordingly, resulting in that the members of the board of directors implementing a less efficient supply and inhibiting the corporation the process of organizational learning. Therefore, the functional structure of directors is negatively correlated with diversification strategy.

4.3. Discussion on the Impact of Diversification Strategy on Financial Performance

Diversification can help companies weaken external risks and potential competitive threats, so as to complete the sharing of resources. Another advantage is that the optimal allocation of the corporation's internal resources can be achieved through the internal capital market, so as to break through the financing bottleneck of the external capital market, create new value, and produce the effect of 1+1 greater than 2, which is commonly referred to as diversification premium. China's GEM listed companies are a relatively special group, with relatively small scale, relatively short of capital, limited level of debt, less extensive influence on reputation, poor financing ability, vulnerable to the impact of the market environment and weak ability to resist risks. Although the above characteristics increase the difficulty for gem listed companies to carry out diversification, diversification is the only way for companies to develop and grow. Therefore, there is a positive correlation between the diversification strategy and financial performance of gem listed companies in China, that is, the diversification strategy of GEM listed companies has a premium effect.

4.4. Discussion on the Mediating Effect of Diversification Strategy on Incentive and Financial Performance of Senior Executives

The influence of senior management shareholding on financial performance is no single and direct, but also affected by intermediary variables. Executive ownership has a direct negative impact on corporate financial performance and can lead to the decline of corporate financial performance through the negative effect on diversification strategy.

On the basis of theoretical and literature analysis, this paper takes employees, creditors, government and institutional investors as the most important stakeholders in the growth stage of gem listed companies. By introducing other stakeholders except shareholders, managers and some board members in the corporate governance environment, it is conducive to promote the smooth implementation of the overall strategy of the corporation and its implementation effect. But because other stakeholders are still relatively weak relative to shareholders, boards and managers have limited influence over corporate strategy.

5. CONCLUSION

In this paper, based on relevant theories and scholars' research viewpoints, the research on corporate strategy and financial performance of the board of directors is discussed in detail. Corporate governance, diversification strategy and corporate financial performance have received the attention of a large number of researchers, at the same time, there are also a lot of research on the relationship between them. The main conclusions of this paper are as follows:

1. From the perspective of corporate governance, this paper studies the mechanism of board governance on financial performance. The research results show that, in general, all dimensions of corporate governance of gem listed companies have a significant impact on financial performance. The specific influences are as follows: there is an u-shaped correlation between the

functional structure of directors and financial performance.

2. Corporate governance dimensions of gem listed companies are significantly correlated with diversification strategy. The functional structure of directors is negatively correlated with the diversification strategy.

3. Diversification strategy is positively correlated with financial performance, that is, diversification strategy of gem listed companies has premium effect at the present stage. The reason may be that diversification can help the gem listed companies resist external management risk, reduce the pressure of competition and achieve resource sharing, and can also be used to complete the corporation internal capital markets resources within the effective configuration. This creates new value and realizes the diversity of 1 + 1 > 2 effect at a premium. In fact, the diversification strategy itself will not harm the financial performance of corporations at all. Listed companies with mature conditions should try to carry out bold horizontal or vertical mergers and acquisitions to further expand the scale of the corporation and extend the industrial chain where the corporation is located, so as to improve the core competitiveness of the corporation and finally achieve the improvement of financial performance.

4. The mediating effect of diversification strategy results show that diversification strategy plays different roles in different dimensions of corporate governance. Diversification strategy in the proportion of tradable shares, financial performance, senior management shareholding, financial performance, executive compensation, mediating role between financial performance was established, which is the proportion of tradable shares, top executives shareholding proportion and executive compensation has direct effects on corporate financial performance in addition to outside, will also influence through diversification strategy indirectly. The mediating effect of diversification strategy on other dimensions of corporate governance has not passed the test and may have an impact on corporate financial performance through other ways.

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