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BOARDROOM DIVERSITY AND FIRMS' FINANCIAL PERFORMANCE: A PROPOSED PRE AND POST ANALYSIS OF MCCG 2012

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ABSTRACT: *Though the previous literature exhibits wide theoretical as well as empirical contradictions regarding the relationship between boardroom diversity and firms' financial performance, the regulators and policy makers still believe that firms' performance is positively correlated with greater boardroom diversity. Subsequently, the newly introduced Malaysian Code on Corporate Governance (MCCG 2012) in March, 2012 recommended boardroom diversity among others for improving firms' conformance and financial performance. However, the role of regulatory intervention for improving firms' conformance and performance is also contradictory and controversial. Keeping in view all of these diverse arguments, the paper proposes further investigation of the relationship between boardroom diversity (gender & age) and financial performance (ROE & EPS) of the listed companies in Malaysia from 2010-2013 in pre and post context of the code. The proposed period explicitly represents 2 years pre and 2 years post enactment period of the new code.*

Keywords: Corporate Governance (CG), Boardroom Diversity, Financial Performance, Pre and Post Analysis, MCCG 2012, Malaysian Listed Companies.

1.0 INTRODUCTION

The practice of Corporate Governance (CG) is as old as the existence of corporations. Its history can be traced back to the establishment of East India Company, Hudson Bay Company, Levant Company and other companies chartered in sixteenth and seventeenth centuries [1]. However, the practice became more popular after the corporate failures of Enron Corp. (2001), WorldCom Inc. (2002), and Global Crossing Ltd. in the USA [2]. These corporate demises proved as a wakeup call for the improvement of corporate governance structure around the world. Consequently, many countries in the world introduced CG legislations and regulations to strengthen CG structure and improve firm performance. It is argued that CG ensures economic sustainability of the firms [3]. Economic sustainability supports diversity (age, gender, ethnicity etc.) in the firm (www.globalreporting.org). CG also advocates boardroom diversity for improving firms' performance. Many established CG theories such as upper echelon, agency, resource dependency, stakeholder, and signaling theories support boardroom diversity [3, 4,6]. However, in contrast, the organizational theory negates these theories by opposing boardroom diversity [4]. The empirical studies also lack uniformity by showing incongruous findings and mixed results. These studies exhibit that boardroom diversity has positive, negative or even no association with firms' financial performance [4,5,10,11]

However, MCCG 2012 has focused boardroom diversity to improve financial performance of the listed companies in Malaysia. The recommendation of MCCG 2012 is in accordance to the argument that the regulations not only enhance CG level of compliance but also improve firms' financial performance [12,13]. However, in contrast it has also been argued that regulatory interventions for improving firm performance are ambiguous and inconclusive [14], [15]. There is a wide contradiction as evidenced by conflicting arguments on either side of the relationship between boardroom diversity and firms' financial performance in theory as well as in practice. Furthermore, the regulatory intervention for improving firms' financial performance also lacks unanimity by exhibiting conflicting arguments. Hence, this paper proposes to investigate the impact of boardroom diversity (Gender and age) as a recommendation of MCCG 2012 (regulatory intervention) on financial performance (ROE & EPS) of the listed companies in Malaysia. The proposed period of analysis is from 2010 to 2013 which clearly shows two year pre (2010-11) and two years post (2012-13) enactment periods of the code. The pre and post comparison of the relationship will highlight the impact of the code (if any) more distinctively.

2.0 LITERATURE REVIEW

The upper echelon theory postulates that heterogeneity like age and gender in board not only avoid group thinking but also improves dynamic discussion [16, [6–8, 16,17]. The proponents of agency theory argue that diverse corporate boards strengthens independence of the board which ultimately improves monitoring role of board [18,4], [5]. The theory of resources dependency also supports boardroom diversity on account that it helps firms link to the resources exist in external environment [4]. The signaling theory favors boardroom diversity since it earns better image for firm by signaling the balanced composition of board to current as well potential investors and society [9]. The stakeholder theory also purports diversity in corporate boards as it develops long term durable relations with all stakeholders [19]. A survey results in the USA endorsed these theoretical postulations by documenting that 75% of the US boards had been improving boardroom diversity for the last three years [20]. In accordance, the commentary # 2.2 of the MCCG 2012 describes that nomination committee on behalf of board should improve boardroom diversity [21]. However, it is also argued that current status of boardroom diversity has no real association with firms' financial performance since it is a cosmetic and mere compliance to the relative legislation and regulation [9]. The organizational theory also opposes boardroom diversity on account that it discourages unity of the board and slow down the pace of decision making which in response restricts strategic changes in the firms [4]. The diverse boards might have issues of directors' personal or geographical interests which might jeopardizes consistency of the board [22]. Many researchers found that firm performance has no relation with boardroom diversity [10,11, 23]. Thus, due to theoretical disagreement, this paper proposes further investigation of the relationship between boardroom diversity and firms' financial performance.

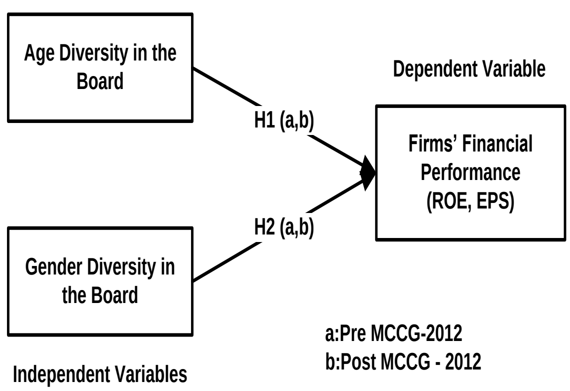

Figure 1: Proposed Conceptual Framework

3.0 STUDY OBJECTIVES

Following are main objectives of the study:

1. To measure the distinct impact of MCCG 2012 on the level of compliance of boardroom diversity (age and gender) in Malaysian listed companies by comparing pre and post context of the code.
2. To measure the impact of age diversity on financial performance of Malaysian listed companies before and after MCCG 2012.
3. To measure the impact of gender diversity on financial performance of Malaysian listed companies before and after MCCG 2012.
4. To measure the impact of Malaysian Government announcement in 2011 for improving women representation in corporate boards up to 30 % by 2016, on level of compliance and firms' financial performance of Malaysian listed companies.

4.0 RESEARCH QUESTIONS

1. What is the impact of MCCG 2012 on level of compliance of boardroom diversity (age and gender) in Malaysian listed companies by comparing pre post context of the code?
2. What is the impact of age diversity on financial performances of Malaysian listed companies before and after MCCG 2012?
3. What is the impact of gender diversity on financial performance of Malaysian listed companies before and after MCCG 2012?
4. What is the impact of Malaysian Government announcement in 2011 for improving women representation in corporate boards up to 30 % by 2016, on level of compliance and financial performance of Malaysian listed companies?

5.0 PROPOSED HYPOTHESES

5.1 Age Diversity and Firms' Financial Performance

Apart from the theoretical wiles and recommendation of MCCG 2012 as discussed earlier, the empirical findings regarding the relationship between age diversity and firms' financial performance are also contradictory. Some studies show positive while other no or even negative relation between age diversity and firms' financial performance. The relationship is inconclusive and unpredictable as age diversity might be good or bad for firms' financial performance [24]. For example, it is argued that age diversity encourages creative thinking and improve problems solving approach of the board [25, 26] which in turn, positively impacts firms' financial performance [26]. The boards with homogenous ages of directors have low performance but by including a couple of young directors the performance of firms can be improved [27].

In contrast, many studies found that age diversity has no link with firms' financial performance[28,29]. Furthermore, it has been documented that average age of directors has negative association with firm performance [30]. The literature regarding the relationship between age diversity and firm performance is not only limited but also diverse [27]. Hence this paper proposes further investigation of the relationship between age diversity and firms' financial performance. The proposed hypothesis on the basis of upper echelon theory is:

H1 (a): The age diversity has positive impact on firms' financial performance before MCCG 2012.
H1 (b): The age diversity has positive impact on firms' financial performance after MCCG 2012.

5.2 Gender Diversity and Firms' Financial Performance

Gender diversity is an important element of boardroom diversity as evidenced by the previous literature [30] [7], [16]. Apart from different theoretical view points and positive anticipation of MCCG 2012, the empirical evidences depict mixed and indecisive findings regarding the relationship between gender diversity and firms' financial performance. For example, some studies show that the relationship is positive while many other documented no or even negative relationship between gender diversity and firms' financial performance.

Many researchers found that women on board has positive association with firms' financial performance [31,5]. It has been found that women board members have better understanding of market and external environment which has positive impact on firms' financial performance [31]. The greater number of women in board improves firms' financial performance [27]. Hence, many countries had introduced legislations to improve women representation in boards. The Norway stood first in this race by passing an act in 2003 to increase women representation up to 40 percent by 2008 [32]. The Government of Malaysia like many other countries had also declared in June 2011 that women representation in corporate boards must be increased up to 30 % by 2016 [33].

However, in contrast, many investigations found that gender diversity has no impact on firms' financial performance [19] [35]. Moreover, many other studies found that women representation in corporate boards negatively impacts firm performance [10,28], and lowers down firms' financial performance [35].The literature examining the relation between gender diversity and firms' financial performance is not only limited but also contradictory [7]. Hence, this paper proposes further investigation of the relationship between gender diversity and firms' financial performance. The proposed hypothesis on the basis of upper echelon theory is:

H2 (a): The gender diversity has positive impact on firms' financial performance before MCCG 2012.

H2 (b): The gender diversity has positive impact on firms' financial performance after MCCG 2012.

6.0 MEASUREMENT OF FIRMS' FINANCIAL PERFORMANCE

This paper proposes return on equity (ROE) [36, 37] and earnings per share (EPS) [38, 39] for measuring firms' financial performance. The measurement proxies will help identify that how boardroom diversity i.e. gender and age diversity impacts firms' financial performance.

7.0 SCOPE AND METHODOLOGY OF THE STUDY

The proposed data of boardroom diversity (gender and age) can be collected from annual reports of Malaysian listed companies from 2010 to 2013. The financial data regarding ROE and EPS of the companies listed in Malaysia can be extracted from DATASTREAM. The proposed period of study will be divided into two sub periods representing 2 years pre and 2 years post enactment period of MCCG 2012. The paper proposes using bivariate (multiple) regression analysis for both sub periods separately and then comparing their results. The comparison of results for pre and post periods will show the distinct impact of the code (if any) on firms' conformance and financial performance. The proposed sample size is 300 companies using stratified random sampling. The proposed sample will represent all sectors of Malaysian economy except finance, banks and insurance companies as they have different governance requirements. The total number of companies listed on Bursa Malaysia was 823 at the end of financial year 2009 (www.bursamalaysia.com).

8.0 SIGNIFICANCE AND CONTRIBUTIONS OF THE PROPOSED STUDY

Apart from theoretical contradictions, there are many other reasons that explain the significance and contribution of the proposed study. First, the relationship between boardroom diversity and firms' financial performance is an inconclusive debate. Thus the proposed study will empirically examine that how boardroom diversity impacted financial performance of the listed companies in Malaysia. Second, the proposed study will investigate that how the recommendation of MCCG 2012 regarding boardroom diversity has impacted firms' financial performance by comparing the results of pre and post periods of the code's enactment. Third, the proposed study will investigate that how the Malaysian Government announcement of increasing women representation up to 30 % in corporate boards by 2016, has been impacted gender diversity and financial performance of the listed companies. Fourth, the proposed study will provide an empirical insight into the inconclusive and controversial debate regarding the role of regulatory intervention for improving firms' conformance and financial performance [12,13, 15]. Fifth, boardroom diversity had less explored area in the CG literature of developing countries [5] and most of the previous studies had targeted US boards which had produced conflicting results [5, 19, [40]. Thus, this proposed study will contribute to the CG literature regarding boardroom diversity and firm financial performance in a developing country like Malaysia.

Finally, many studies in the past had examined the pre post impacts of the previous CG codes i. e. MCCG 2000 and MCCG 2007 in Malaysia [41–45] which necessitates similar investigation of this new code (MCCG 2012) in a similar context. Hence, this paper proposes to examine the impact of boardroom diversity (gender and age) on firms' financial performance in pre (2010-2011) and post (2012-2013) context of the code for more distinct impact of the code and filling the exhibited literature gap. Moreover, the results of proposed study will help Government, regulators, policy makers, board of directors, Bursa Malaysia and Securities Commission of Malaysia in further improvement of the relevant policies and regulations in future.

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