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The Effect of Gender Diversity and Board Independence on Firms Performance

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Abstract

The occurrence of high-profile firm collapses and corporate scandals serves as evidence of deficient corporate governance, which renders institutions brittle and susceptible to long-term negative impacts on firm performance. Therefore, the introduction of the Malaysian Code on Corporate Governance (MCCG) aimed to enhance the corporate governance practises of listed companies and therefore enhance their overall performance. Given the uncertainty on the causal relationship, it remains relevant to undertake further research on the potential impact of good corporate governance on firm performance. The objective of the study is to examine the effect of internal corporate governance namely: (i)gender diversity and (ii)board independence on Malaysian firm's performance, relying on both agency theory and resource dependency theory. For the purpose of to examine the relationship between gender diversity and board independence while controlling for firm size, leverage, and market capitalization, a panel data approach will be used with the top 100 companies listed on Bursa Malaysia. This approach will use various performance measures (Return on Asset, Return on Equity, and Tobin's Q). Our research will contribute to additional literature and insights to policymakers on the sufficiency of existing regulations relating to internal mechanisms of corporate governance specifically on the restriction to number of board members as well as empowering women on board, and consequently contribute to the benefit of stakeholders at large.

Keywords: Gender diversity, Board independence, Corporate governance, Agency theory, Firm performance.

Introduction

Good corporate governance practice is widely accepted by most corporations, especially public listed companies to enhance transparency, attract new investments, inculcate good corporate culture, curb misconduct, promote equality and fairness and subsequently boost the firm performances. It is perceived as the important aspect of morality and ethical behaviour within firms that support overall social and legal environment. The board of directors being one of the internal corporate governance mechanism responsible as strategic decision makers of a firm and responsible to achieve firm's goal while creating shareholder's value (Abdullah, 2016). However, a conflict arose as a result of the separation between ownership and control, leading to a situation where individuals may prioritize their personal interests over those of shareholders, employees, and society. Thus, corporate governance plays a vital role to lessen the conflict of interest between firms and shareholders, consequently drive corporate performance and survivability (Mohamad, Muhammad Sori, Alshirah, Alfawareh et al., 2022).

The performance of listed firms in Malaysia has changed significantly since the Malaysian Code on Corporate Governance (MCCG) was first implemented in 2000 (Bhatt, 2016). Since then, MCCG had gone through several revision to keep update with the recent legal development. These government advocacy and regulations on corporate governance matters would be appealing for foreign investors to invest in Malaysia. Furthermore, strong governance frameworks are suggested as a prevention measure for financial and economic crises as well as in the event of future catastrophes (Abdullah, Aziz & Azani, 2022). The goal of governance processes is to outline how management should rank the interests of shareholders. Hence, reforming and extending sound corporate governance is not an easy task and do not guarantee to be successful. Corporate governance is also not a "one size fits all" rule. It must be customised for the nations in which businesses operate and take into account regional norms (Mohamad & Muhamad Sori, 2012).

The growing interest of academics in corporate governance study has been driven by the rising economic value of emerging markets and the benefits of living in an industrialised country. Moreover, the corporate governance mechanism in Malaysia is anticipated to have reached maturity after 22 years being introduced (Abdullah et al., 2022). Thus, the objectives of this study are to examine the effect of gender diversity of board members and board independence on firms' performance. This study will address the apparent research gap and extend the literature in Malaysian context by examining the effect of gender diversity and board independence on firms' performance.

Problem Statement

Over the last two decades, Malaysia has made considerable effort on corporate governance reforms to strengthen the practices and standards. The Companies Act 2016 governs the regulatory framework of companies set up in Malaysia while the Malaysian Code on Corporate Governance (MCCG) set out the best practices to fortify the corporate governance practices of public-listed companies (PLCs). The latest updates on MCCG focused on enhancing of board policies and practices in order to keep firm's governance intact and subsequently improve performance and growth (MCCG, 2021). On the other hand, firms also have taken initiatives to strengthen their governance procedures and enhance corporate accountability. There are increasing number of studies on exploring the corporate governance impact on different aspects of firms in the Malaysian market. However, limited studies examine the empirical investigations in this concerned area (Khatib, Abdullah, Elamer & Hazaea, 2022).

One of the internal corporate mechanisms of a firm is the board of directors. Highly effective board directors are in high demand to foster a dynamic work environment in which they set strategies and oversee the entire business operation in order to boost the company's growth. It is crucial to have a diverse and knowledgeable group of people on the board so that it can effectively perform its role. Appointing women on board of directors promotes gender diversity which offers a wider range of knowledge, ideas and different thoughts in managing the business. This would lead to a more productive working environment and ultimately increase firm's performance. On the other hand, independent directors effectively keep an eye on the business surveillance while controlling managers' decisions and reducing agency problems, thereby improving firm performance.

This study addresses the apparent research gap and extend the literature in Malaysian context by examining the effect of gender diversity and board independence on firms' performance.

Thus, the objectives of this study are:

1. To examine the effect of gender diversity of board members on firm's performance
2. To examine the effect of board independence on firm's performance

Literature Review

Development of corporate governance in Malaysia

The Malaysian Code on Corporate Governance (MCCG), which was first released in 2000, has been a vital tool for corporate governance reform and has had a positive impact on companies' corporate governance practises. Its structure is based on a number of laws and regulations, including the Companies Act of 1960. To enhance corporate governance procedures, a number of updated corporate governance codes were introduced in Malaysia. The MCCG was reviewed and revised in 2007, 2012, 2017, and 2021 to make sure it stays current and is consistent with widely accepted best practises and standards. Following the Asian financial crisis that occurred in 1997, the Security Commission (SC) in Malaysia issued the first Malaysian Code on Corporate Governance (MCCG) in the year 2000 with the intention of improving the corporate governance mechanisms of listed companies. The MCCG 2000 was adopted by Bursa Malaysia in 2001, and at that time, all listed companies were required to comply with the recommendation or explain the current practice in the annual report (Abdullah, 2016). Although the MCCG is applicable to listed firms, it is suggested that non-listed firms, such as state-owned enterprises, public companies, small and medium-sized enterprises (SMEs), and licenced intermediaries, implement the practises under the MCCG.

Since the publication of MCCG 2000, numerous reforms to corporate governance in Malaysia have been implemented as a response to a variety of problems, the most notable of which was the scandal surrounding Enron's case in the US in 2000. In particular, the Supreme Court published an updated version of the MCCG in 2007 as a reaction to the scandal involving Transmile in Malaysia and as a means of incorporating new developments in the principles and practises of corporate governance in the United States and the United Kingdom. The primary goal of the MCCG in 2007 was to bolster the audit committee and define the criteria that the nomination committee ought to take into consideration when deciding who should be nominated for director positions. In 2011, the Securities Commission (SC) released the Corporate Governance (CG) Blueprint 2011 with the objective of enhancing corporate governance procedures in Malaysia and fostering a culture of sound governance. MCCG 2012 was one of the outputs that came out of the CG Blueprint 2011 project which focused on directors' appointment in ensuring board independence.

In 2017, the newly amended version of MCCG was implemented in an effort to strengthen the independence of the board. It placed an emphasis on promoting gender equality by

increasing the number of women in top management and board positions. Additionally, it necessitates that the remuneration policies of the Board be revealed in great detail on the company website. Other than that, the establishment of a Risk Management Committee, a strengthening of the independence of the Audit Committee, and an improvement in directors' and shareholders' involvement in the Annual General Meeting are some of the additional improvements that were formed under MGCC 2017.
In 2021 the MCCG was further revised to focus on techniques that are generally recognised over the world that covers improvements to Board Procedures and Policies, enhancing the board's oversight and integrating sustainable business practises throughout the company's strategy and operations, and the implementation of industry standards, particularly for businesses that have poor levels of compliance. As the landscape is still recovering from the consequences of the COVID-19 epidemic, the MCCG 2021 helps boards in their efforts to create long-term sustainability by adopting and implementing rules and practices related to corporate governance.

Board of directors

Corporate boardrooms play a major role in making important decisions for a company on behalf of the stakeholders. Highly effective board directors are in demand to cultivate a dynamic work environment where they set strategies and oversee the whole business operation to enhance company's growth. To guarantee company survival, the boards ensure the expectations of the different interest groups are met. The long-term support from the stakeholders can only be achieved when they receive adequate information about company affairs. Prior research provide evidence on the role these directors play to exert significant pressure on companies to increase corporate transparency by disclosing more information (Fuente, García-Sánchez, & Lozano, 2017). Results found a significant positive association between the role of the board and sustainability (Chams & García-Blandón, 2019).
Other studies on social network showed that the diverse experienced members of the board enable easy knowledge transfer across firms (Baum, Lööf, Stephan, & Viklund-ros, 2022). They help companies acquiring resources through the many networks of connection with external parties. The board is also the integral mechanisms for good corporate governance (Hamid & Purbawangsa, 2022). Past research indicated a link between corporate governance and company performance. The board ensures an effective monitoring activity, and this positively affect firm performance (Kao, Hodgkinson & Jaafar, 2019). The board oversees the management and provide them with direction and leadership which will lessen the agency problem and it has an impact on company success (Merendino & Melville, 2019). In recent changing environment, there has been a considerable shift in the expectations for board members. The choice of a particular board structure might have affected how well companies operate and sustain growth.

Agency theory and resource dependence theory

The conflicts between shareholders and managers are described in agency theory whereby managers who act as agents tend to behave in a way that maximizes their own personal benefits over the interest of principals (shareholders) (Jensen and Meckling, 1976). The main goal of agency theory is to emphasis on the importance of adopting a corporate governance code as a standard practise to reduce such conflicts of interest, including the appointment of independent directors on the board of directors who will effectively keep an eye on the business surveillance.

On the other hand, according to the proponents of resource dependence theory, the presence of a diverse board of directors makes it possible to ensure the availability of resources that are crucial for minimising operational risks and improve firms performance (Reguera-Alvarado et al., 2017). Appointing women on boards of directors promotes gender diversity since they often bring different ideas and perspectives to the table in terms of expertise, skills, management styles, and values. Thus, having women on board brings diverse perspectives, a broader range of skills, experiences, insights and strategies, to the boardroom resulting in stronger governance (Bustamam, Adanan, Abd Samad, Mamat et al., 2022).

Gender diversity

A workforce that exhibits diversity encompasses a wider array of knowledge, ideas, and perspectives, hence fostering a more efficient and effective working environment, ultimately resulting in enhanced organizational performance. In light of its significance, organizations are increasingly endeavouring to enhance gender diversity among their board of directors. It has been proven that companies empowering these differences do better than companies that are not. The need for a female presence on corporate boards has been studied from a few contexts; ethical/psychological/management/economic. Women tend to exhibit greater ethical discernment compared to males due to their heightened sensitivity towards risk-taking. (Mather, Ranasinghe & Unda, 2021). In Wang, Yu & Gao (2022), it has been proven that women are risk-averse and commit to ethical business practices. From a psychological perspective, women are very diplomatic, tolerable, and less aggressive. It helps to moderate the overconfidence of its male counterparts on the Board of Directors (Chen, Leung, Song & Goergen,2019). Women take other factors such as humanity into making decisions (Kuzey, Fritz, Uyar & Karaman, 2022). Women value relationships over personal gain and as a result would make better judgments for all stakeholders. (Kuzey, Fritz, Uyar & Karaman, 2022).

The presence of gender diversity on boards has been found to enhance monitoring functions, since women tend to allocate more time to board activities and exhibit more attention to detail. From an economic point of view, Mather et al. (2021) reported that women are very cautious and when women dominate the firms, it showed low volatility in profits. Another study reported that better-performing firms would demand more women on Boards as it is associated with performance relationships (Mohsni, Otchere & Shahriar, 2021). In sum, having women on boards bring divergent thinking, a wider mix of talents, experiences, insights, and strategies to the table resulting in stronger governance. Better governance inevitably leads to better results (Broadmann, Hossain & Singvi, 2022). Tran, Nguyen & Tran (2019) found that the difference in gender affect firm's growth. However, certain research suggest that the presence of gender diversity may yield advantages for certain firms while resulting in disadvantages for others. Diversity would hurt productivity because people are more likely to form positive communication with ingroup members (those of their own gender) than with members of another gender (Zhang, 2021). Thus, evidence suggest a threshold effect on the women participation on board.

Board independence

Board independence refers to the extent to which a company's board of directors is composed of independent directors who are not affiliated with the company or its management. There has been a considerable amount of research conducted on the relationship between board independence and firm performance. One of the main findings is that greater board independence is generally associated with better firm performance as evidenced from prior research (Abdullah et al., 2022; Farooq, Noor & Ali, 2022 and Handriani & Robiyanto, 2018). This is due to the fact that independent directors are more likely to act in the interests of shareholders and to provide objective oversight of management decisions. Besides that, independent directors are also seen able to reduce the agency problems in the firms and work as an effective monitoring mechanism to protect shareholders, restrain the self-interest behaviours of managers and can effectively promote better firm performance (Shan, 2013; Johl, Khan, Subramaniam & Muttakin, 2016).

However, the relationship between board independence and firm performance is not always straightforward. Some studies have found that the relationship is not significant or even negative or inverse, suggesting that other governance factors may be more important in determining firm performance. This is consistent with a study conducted by Al-Saidi (2021) found that board independence negatively affected firm performance based on Tobin's Q in Kuwait firms because the current independent directors are not adding value to Kuwait's listed firms due to the conflict between large shareholders and small shareholders could affect the role of independent directors in Kuwait. Shan (2019) also found there is an inverse relationship between board independence and firm performance in Australian listed firms following agency and stewardship theory. One potential explanation for these mixed findings is that the effectiveness of board independence depends on the specific context of the company and the industry in which it operates, for instance board independence may be more important in highly regulated industries where there is a greater risk of ethical and legal violations.

Conclusion

In summary, the existing body of research pertaining to the impact of gender diversity and board independence on firms' performance yields inconclusive results. Some studies have found that a more gender-diverse board and a more independent board are associated with better firm performance, while others have found no significant relationship. The causes for these divergent outcomes are multifaceted and contingent upon various factors, including but not limited to the particular sector, geographical location, and other contextual elements. Nevertheless, there exist some justifications to support the notion that a board comprising a greater gender diversity and increased independence could potentially enhance business performance. Gender-diverse boards have the potential to enhance decision-making processes by including a range of perspectives and experiences. Furthermore, it might be argued that independent directors are less susceptible to the influence of management and are more inclined to prioritize the welfare of shareholders. Moreover, it is plausible that both boards comprising various genders and independent boards are inclined towards questioning management decisions and ensuring their responsibility for their activities.

Motivated by the latest update on MCCG in 2021, which have empowered board policies and women on board, and the inconclusive results of previous studies, this study contribute to the literature and Malaysian environment in various ways. Firstly, it provides an analysis on internal corporate governance mechanism which initially developed in Western countries, implemented in developing country with different atmosphere of regulatory and economic setting. This provides an intriguing area for research due to the interaction of institutional and societal characteristics. Secondly, this study adds new evidence regarding the effect of gender diversity and board independence on firm performance under Malaysian literature immediately following the updated of MCCG. This type of study allows researcher to gain deeper understanding on how governance policies and procedures impact the firms' financial performance in the setting of Malaysian culture and customs.

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