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DIVERSITY WITHIN THE BOARD OF DIRECTORS

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Abstract: *This article aims to explore the importance of the diversity of boards within the composition of the board from a corporate governance perspective. Much of the available literature appears to focus on demographic diversity, in particular gender, in the sense of board diversity research. However, there are other forms of diversity that are essential in diversity, such as social capital, political and human capital. As a result, four forms of diversity have been reviewed here, including gender diversity, social capital diversity, political diversity and human capital diversity. A brief glimpse of how Malaysia is addressing the diversity of boards can also be found in the discussion of this post. In general, all four types of diversity make a positive contribution to businesses, especially in terms of results. However, there is a lack of board literature on human resource diversity accessible from an empirical point of view in general at this point of time.*

Keywords: Board Composition, Diversity and Corporate Governance

1.0 INTRODUCTION

The board's composition remains a key component of corporate governance, as previous research has shown that it can bring wonders to a company with the right composition, such as financial performance in the company [1], corporate social responsibility [2] and innovation [3]. Although previous empiric studies such as [4], [5], [6] seem to be exploring more about the traditional dimensions of board composition, such as the scale, the independence of directors and the duality of CEOs, there is a need to broaden the horizon and consider the possibility of other dimensions that may affect the composition of boards. And diversity is one of those potential dimensions [7], [8], [9]. Results on the impact of diversity in the top or the top management of enterprises have been contradicted in the management literature. For example, Homberg and Bui (2013) [10] did not find any impact on corporate success, although Nielsen and Nielsen (2013) [11] found otherwise. It should be remembered, however, that senior or senior management and board members are two different bodies, since the positions and duties they have performed are certainly distinct [12]. The emphasis in this report will therefore be on the members of the Board. In this sense, according to Rao and Tilt (2016) [2], diversity refers to board members who have different characteristics and characteristics, such as gender, age, culture and so on. However, as the authors have pointed out, not all these characteristics or dimensions are of similar significance. Demographic dimensions [13], e.g. gender diversity, may be one of the most significant variations that has drawn the attention of researchers in recent years. One of the disadvantages in this regard, however, is that researchers do not examine or lack the focus on exploring other dimensions of the diversity of boards that may have the same powerful impact as gender. Johnson, Schnatterly and Hill (2013) [14] found this in their study in which human capital, social capital and political prowess such as business experience, personal & political relationships or affiliations, serve as a key determinant of diversity that, in some ways, has a major impact on the organization.

In this article, we will examine how diversity affects corporate governance by looking at some of the aspects that are considered to play an important role in it. Finally, with regard to the diversity of boards, we shall have a quick look at the position of Malaysia under discussion.

2.0 LITERATURE REVIEW

2.1 Gender Diversity on the Board

The demand for changes in the composition of the corporate board is global and is motivated by the publication of corporate rankings on diversity, media coverage, stakeholder calls, legislative or regulatory improvements and the implementation of good corporate governance practices. The global response is either authoritarian, promoting or laissez-faire [15]. Certain European countries are implementing compulsory quotas for female participation in corporate boards, known as feminization legislation [16]. Women are in a position to make more educated choices and provide boards with contrasting opportunities than all men [17]. The impact of women on the decision-making process is increased as the number of women on boards of directors increases [18]. The result of this is the moral influence of human beings [19]. A collection of literature explores the differences in decision-making ethics between men and women. Women marketing practitioners have a higher ethics assessment relative to their male counterparts [20]. The findings of Bernardi, Bosco and Columb (2009) [21] indicate that, if the corporations are Fortune 500, a higher percentage of women on the board is related to being listed as one of the 'Most Ethical Organizations in the World.' Research results by Ben-Amar, Chang and McIlkenny (2017) [22] show that gender diversity improves the board's efficiency and promotes the introduction of stakeholder management. The findings show the positive effect of the diversity of boards on corporate social responsibility initiatives [23] and on the accuracy of financial statements [24]. Literature suggests that there is a correlation on the board between corporate governance, in particular gender diversity and corporate performance [25]. However, Wagana and Nzulwa (2016) [26] noted that while there is a strong record of the diversity of board members in financial results, few studies have been conducted to investigate whether non-financial performance indicators are involved. It is well recognized and argued in the literature. Moreover, gender diversity research has been carried out mainly in developed countries, which vary from developing countries, such as Malaysia, in terms of economic and socio-cultural structure. In the meantime, Kim and Starks (2016) [27] have shown that gender diversity increases the value of business where female directors bring additional experience to boards and contribute to enhanced consulting performance. They have also shown that women diversify board experience more than their men do and provide their boards with specific skills. These findings show that by putting different skills together, female directors can increase the effectiveness of advisory boards. The gender-divergent board therefore has the potential to increase the valuation of the company, in conjunction with the findings of Kim and Starks (2015) [28] that the greater heterogeneity and experience of the director is correlated with the greater value of the company. To date, however, the question of the proportion of male and female directors on board to ensure the effectiveness of the board remains unclear.

2.2 Social Capital Diversity on the Board

Another key dimension of the Board's diversity, according to Booth-Bell (2018) [29], is the social capital provided to the Board by the Board of Directors. Social capital is the idea that an individual and a society will be helped by membership of a group. Adler and Kwon (2002) [30] explained that social capital is driven by a fundamental sense of goodwill, such as the kindness, trust and forgiveness of friends and acquaintances. Social capital is seen by Lin, Vaughn and Ensel (1981) [31] as resources inherent in the social network of individuals and available through both direct and indirect connections. Portes (1998) [32] describes social capital as 'the ability to benefit actors through social networking or participation in the social system.' Theoretically, in order to have social capital, a person, community or organization must have relations with others, and this relationship is a true source of social capital value [32]. Additional services can also be given to the company, such as reputation [33], advice, consulting

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and other organizations [34] or other social capital assets that the director may offer to the company as a result of the appointment of the board of directors. It can also act as a means of covering or bridging structural gaps or vulnerabilities. Social capital can also influence the outcomes of the Board [35]. The success of the team depends in part on the ability of the participants to access and exchange information from their internal and external relations networks [36]. Boards that have strong market ties and greater access to more and better information with other strategically linked companies, leading to better advice and financial performance [37].

In addition, Tian, Haleblian and Rajagopalan (2011) [35] explained that social capital consists of two types of corporate governance: internal and external. Internal social capital is built on the experience of group members working together. Shared co-working experience gives group members the opportunity to create a type of "bonding" of social capital that is held collectively by all group members [30]. Familiarity with the Executive Director increases the Board's capacity to develop a tacit, company-specific experience. Although independent directors can obtain company information from secondary sources, secondary information can hardly be viewed and interpreted by directors in the corporate context unless they have the necessary company-specific knowledge. Second, the experience of co-work gives managers the ability to communicate and organize their own individual skills and know-how, so managers strive to develop a shared understanding of who knows what on the board over time. Research shows that co-working environments enable groups to understand, connect and coordinate their individual experiences [38]. In a similar vein, directors with long experience in cooperation will develop shared group-level knowledge based on their own understanding of each other's skills and interaction dynamics [39]. The external governance network of the Board is a major source of its external social capital [34]. Broad work has shown that relations play an important role in the distribution of data between businesses [40]. These links minimize the cost of scanning [41] and improve access to competitive knowledge and opportunities [42], which may explain the positive impact of the market when a CEO is invited to join another company as a member of the board of directors [43]. Interestingly, there is a lack of research on corporate performance that examines the diversity of social capital on boards. This relationship has been stated by Ooi, Hooy and Som (2015) [8], and it has been found that there is a significant relationship between the two. While the emphasis in their study was on the tourism industry, the author added that it was strong enough to extend it to other industries.

2.3 Political Diversity on the Board

Political diversity is a special type of social capital diversity that merits further development. As long as there are companies, there will definitely be roles in politics [44], including within the board of directors. According to Nasurdin, Ahmad and Razalli (2014) [45], it's a matter of how pervasive politics can be in companies that could be good or bad for their stakeholders and ultimately for the company to create value. There are some interesting findings on political diversity in terms of influence and linkages that the Board of Directors may have from an academic point of view for both developed and developing countries. Gray, Harymawan and Nowland (2016) [47] found that political diversity had little or no effect on the value creation of companies in developed countries such as Australia. They also added that this could be due to a low level of corruption, for example, where political influence with the government of the day might have little relevance to it. Olthuis & van den Oever (2020) [46] conducted a study in the Netherlands, a developed country that agreed with Gray, Harymawan and Nowland (2016) [47] on work where it was found that political ideological homogeneity is preferable to heterogeneity. However, research conducted in Italy, another developed country, found that there is a significant relationship, generally a negative relationship, when executive directors have both political connections and influence within the company [48]. This may be due to their perception of society and their feelings about the political power at play in the country, such as how they view the government's conduct, how close the board of directors is to the politicians, etc. [49]. However, in a developed country where the government has the highest authority, such as China, political diversity within the board, which tends to favor the ruling government, will positively influence the performance of the company and, subsequently, the creation of value for its stakeholders [50]. In developing countries, political diversity, which is more aligned with the government of the day among board members, is seen as a competitive advantage for companies due to the financial and non-financial benefits that it could bring to them [51], [52], [53]. This is consistent with the findings of Boubakri, Guedhami, Mishra and Saffar (2012) [54] that political ties are more important in developing countries than in developed countries. While the outcomes are indeed desirable for the stakeholders, the means of using political influence remain a long-standing issue. Hasnan and Marzuki (2017) [55] looked at the relationship between the political link and the incidence of financial re-examination that has had a significant positive relationship in Malaysia. Financial revisions may be legal within the legal framework, but if the incidences occur too frequently, this may be an ethical issue that the company needs to address. Sharif, Yeoh and Khong (2015) [56] and Chong, Ong and Tan (2018) [57] agreed that political diversity is important among board members and suggested that directors with an influential political connection be made independent rather than executive in order to ensure conflict of interest, non-compliance and ethical issues can be minimized. The answer to the question as to the extent to which political diversity should be diverse remains unanswered as there is no standard answer to it. As can be seen from the discussion above, there are internal and external factors that need to be considered thoroughly before the ideal level of political diversity in a particular company can be determined.

2.4 Human Capital Diversity on the Board

Human capital is defined as the resources of individuals [58]. Human capital is a vital organizational asset that directly correlates with an innovative service pattern that satisfies consumer demands and increases the productivity of businesses [59]. Colombo & Grilli (2005) [60] and Hsu (2007) [61] pointed out that businesses with higher human capital capacity are likely to better evaluate their competitiveness and that workers can boost their employment performance and eventually increase the efficiency of the business as human capital continues to grow. This conclusion can also be found in other sources of literature [62]. By investing in an internal stock of expertise or in the acquisition of external experts, companies are increasingly trying to create and maintain competitive advantages. This increases the circulation of knowledge among the organizational members, facilitates the development of common concepts and enables the capacity to be synthesized and reconfigured [63]. Similarly, via newly acquired external expertise via recruiting, the company can restructure its information portfolios and create significant synergies from its knowledge assets [64]. Thus, the competitive capacity of companies stems from rare combinations of retention and creation of new information properties [65]. The concept of human capital has also recently begun to attract attention to boards of directors of literature [14]. Some of the previous work has been hypothetical, but based on what has already been discussed, it should have the same effect. While the human capital of managers has received significant empiric attention, only a few studies have attempted to relate the board's human capital directly to the meaningful performance of the business. Khanna, Jones and Boivie (2014) [66] have been able to demonstrate that human resources can improve the productivity of organizations as long as the knowledge management requirements that managers need to follow are relatively low. Ooi, Hooy and Som (2015) [8] found similar results, although it should be noted that social capital tends to be more powerful than human capital. However, it is also an important outcome since it provides human capital and corporate governance literature that focuses on the relationship of increasingly nuanced human capital measures to real results [37]. In order to discover its nature, context and implications inside boardroom activities based on empirical study and examination, for example, it is important to continue the ongoing evaluation of human resource diversity on board.

3.0 CONCLUSION AND DISCUSSION

Malaysia's stance on board diversity can be clearly seen via its Malaysian Corporate Governance Code (MCCG) 2017 [67], in particular Principle A – Board Composition from Practice 4.1 to 4.7. For example, in Practice 4.6, it reported that at least 30 per cent of board members who are women for large corporations demonstrate that they consider gender diversity to be a significant agenda within the board of directors. In this case, large companies apply to companies in the FTSE Bursa Malaysia Top 100 Index or with market capitalization of RM2 billion or more. As regards the diversity of social and human resources, it specifically states its stance, for example in Practice 4.6, that the selection of board members is based on objective standards, competence and due consideration for the diversity of expertise, experience, age, cultural context and gender. In terms of political diversity, the MCCG did not take any position on this subject. However, it is common knowledge that direct and indirect political appointment to the Board of Directors is a common practice in Malaysia among government-linked companies [68], [69], [70]. As for non-government-linked businesses, in particular public-listed companies, the political power of a retired civil servant or an inactive politician appears to be pursued as independent or non-executive directors of such companies [71], [72], [73]. Although there is no denying that there is political diversity on the Board, such diversity appears to be limited and more susceptible to the ideology of today's government. Though things seem to be looking positive and promising on Malaysia's board of directors in general, there are still a few grey areas that need to be ironed out. For example, why do at least 30% female directors apply to large companies but not to small and medium-sized ones? And MCCG is only made compulsory for listed companies and not for unlisted companies. Therefore, there is often a risk that unlisted firms will not comply with these practices. Also, among the listed companies, due to the nature of MCCG's hybrid approach, some of these companies may prefer not to adopt as long as they can explain the reason(s) for doing so. Malaysia's authority needs to look into this matter if it is serious about wanting businesses to enjoy the benefits of board diversity. At the end of the day, it is also a matter of ensuring that businesses recognize the value of diversity and take action to ensure that they follow it. After all, this is to enhance corporate governance in Malaysia.

4.0 FUTURE RESEARCH

A follow up empirical study should focus more on human capital diversity, social capital diversity and political diversity within Malaysia context in the near future. This is because there are still quite a number of unresolved issues regards to human capital diversity, social capital diversity and political diversity, such as how diverse should it really be to ensure all the relevant stakeholders, especially from the public entities such as listed companies, will be able to enjoy the optimal returns or benefits that they truly deserved, considering there is no black and white that mentioned this particular matters. A balance in terms of diversity will probably be the best outcome, however it still depends on the society and the authority sentiment especially on political diversity which can be a sensitive subject if approach it from the wrong perspective. Hence, a qualitative based empirical research will be appropriate to capture the underlying sentiment among the company major stakeholders, especially the society and the authorities.

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