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Ethnic Diversity on Boards and Market Performance: An Empirical Investigation in Malaysia

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This study seeks to examine the relationship between ethnic diversity among board members and market value of listed firms in Malaysia. Ethnic diversity is defined as the number of non-bumiputra (Chinese, Indian) on the board of directors. The concept of value-in-diversity argues that a diverse workforce is beneficial for business organization. Diverse members of boards enhance the overall performance of the organization. Literature shows that there is ambiguity among previous researches. The results seem to be inconsistent. There is a need to investigate this issue in a more holistic way. This research is unique and first of its kind that consider the relationship between ethnic diversity on boards with market value. The results indicate that ethnic diversity does have an impact on market value, but they are inversely correlated. The results also indicate that the proportion of non-bumiputra on boards tends to increase with the increasing members on board. However, ethnic diversity is negatively associated with market performance. The outcomes of the research help to shareholders, and other stakeholders, including the potential investors and policy makers to understand the significance of ethnic diversity at top level management.

Keywords: Board of Directors (BODs), Diversity, Ethnicity, Firm Performance, Market capitalization

1. INTRODUCTION

Organizations are currently facing critical issues of gender, racial, ethnicity and cultural composition of board of directors and every member of organization passing through these issues in big & modern corporations. Diversity concept originated in North America and has slowly taken hold in other countries and in whole world¹⁻². Diversity and corporate governance has a strong relationship in context of top-level management. Boards of directors are leaders in the organization. They always take strategic decision and set strategic goals. Board performance and efficiency can be measure through firm performance³⁻⁴. Cognitive and demographic diversity requisite to perform effectively. Ethnic diversity among board of directors can perform their responsibilities more effectively in⁵.

Diversity at top management level provides an advantage for firms. Researchers have argued that diversity at board level has a relationship with firm performance. Board members experiences, perspectives, and values that can boost up overall performance⁶. More

innovation and creativity comes by diverse boards and teams which directly enhance firm overall performance⁷. Research found that diversity among boards has a positive or negative effect depends on organizational strategies. Diversity is helpful for organization in certain conditions⁸. According to⁹ diversity at top management level improve the overall performance of organization. Specifically, it improves decision-making process, policies and procedures, and business networking.

Researchers found ethnicity and firm performance has a positive and significant relationship in Malaysian context¹⁰. According to¹¹ they argued that in Malaysia representation of foreign directors at board level not good and very slow in progress. Some researchers have found that there is no relationship between ethnic diversity and firm financial performance in Malaysia¹².

In contrast, researchers found that ethnic diversity among board members could result in poor firm performance. Ethnic diversity has a positive relationship with firm performance. There is ambiguity in past studies. The results seem to be inconsistent. There is a need to investigate this issue in a more holistic way.

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1.2 Objectives and Focus of the Study

This study seeks to examine the effect of ethnic diversity at board level on market performance of organizations. The sub objective of this study to see the impact of the board size on market performance and secondly, sector influence on market performance in the presence of the ethnicity. It is of great interest for many researchers to explore the ethnic diversity with regard to firm performance. Ethnic diversity at corporate boards have different scenario in listed companies. This empirical study is therefore able to offer more insights on ethnic diversity at board level. To observe the trend and on how companies with high ethnic diversity are performing. This study also includes the extent to which the findings differ from the general expectation as argued by the previous studies. The focus of this study is Malaysian listed companies in BURSA, Malaysia. Three leading sectors considered to examine this study.

1.3 Hypothesis

H1: Ethnic diversity among the board members (BODs) has a positive impact on firm (market) performance.

H2: Board size has a positive impact on firm (market) performance.

H3: There is a significant difference of ethnic diversity among three sectors with regard to market performance.

The main contribution of the study result is to present Malaysian government and other regulatory bodies fundamental information for designing proper policies to support the country's growth. This research is one of its kind due to the fact of its consideration of relationship between ethnic diversity on boards (i.e. non-bumiputra among board members) with market value. A total sample of 565 large companies is considered from the population of 938 listed companies. The three largest sectors are trading/services, finance, industrial products which consist of 233, 43, 289 companies respectively is evaluated. Descriptive statistics, graphical presentations, Anova, regression and correlation test have been used.

The remainder of the paper follows as such Section 2 explains relationship between ethnicity and firm performance, theoretical perspective. In section 3, ethnicity issues in Malaysia and section 4 explain theoretical framework of this study. Results and discussions are explained in section 6. Finally, our work of this paper was concluded in last section.

2. THE RELATIONSHIP BETWEEN ETHNIC DIVERSITY AND FIRM PERFORMANCE

Ethnic diversity and its impact on firm performance is essential for any organizations which are operating in this dynamic environment. In context of board diversity, boards consist of different members with different characteristics and backgrounds, e.g. gender, age and ethnicity which cause advantage for success of firms. There is a strong relationship between diversity and firm performance. Diversity could lead to a firm's competitive advantage³⁻⁴.

2.1 Agency Theory

Agency theory explains the relationship between principal (owners) and agents (managers). The theoretical framework of this theory is most often used in business and economics. This theory use to understand the relationship between board characteristics and firm performance. Agency theory resolves agency problems between managers and owners by using a diverse board¹³. However, agency theory does not predicts clear overview about relationship of board diversity and financial performance¹⁴.

2.2 Upper Echelon Theory

Researcher⁷ argued that board of directors have influence and brings organizational outputs like firm financial performance and strategic edge. This theory aimed on team demographic diversity and cognitive diversity on organizational performance. Researcher argues that cognitive diversity can enhance the team ability, decision-making and firm financial performance. They can make better decision and polices because they are from different backgrounds. This study will base on upper-echelon theory, because this theory explains the board characteristics and its impact on firm performance.

3. ETHNIC DIVERSITY AND ISSUES IN MALAYSIA

Malaysia is a country with diverse population. There are three main ethnic groups: Malay (Bumiputara), Chinese and Indian (Tamil). Malaysia is characterized by religious basis, customs, and languages and on values basis. This national diversity has a relation with diversity on corporate boards. Boards with ethnic diversity enhance and create the value of firm. However, ethnic diverse board can be positive image for organization⁹. Malaysia has a population of 24 million with dominantly Malays 61.5 percent, Chinese 26 percent and Indians 7.7 percent. The cultural context of the country shapes its nations population and workforce. In addition, there are some factors that may be effect diversity which is "organization age", "organization type" "organization size", and diversity of the workforce of an organization.

Board diversity at top level management and its impact on financial performance and found different results and inconsistency in previous studies⁵. In view of above theoretical perspective discussion and some previous researches that ethnic diversity at board level has different outcomes.

The below line chart Fig.1. presents that females of ethnic groups (Malay, Chinese & Indian) are participating in workforce, but majority of the female workers in the "Professional category or clerical support workers" and "Service and Sales workers category" as compared to male professional workers. (Department of Statistics, Malaysia - Report, 2012).

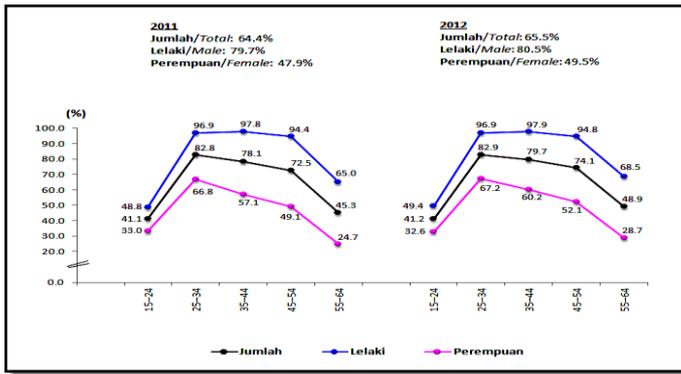


Fig.1. Line Chart – LFP [Source: DOS, Malaysia, 2012]

4. THEORETICAL FRAMEWORK OF ETHNIC DIVERSITY AT BOARD LEVEL AND FIRM PERFORMANCE

The below Fig.2 theoretical framework presents the relationship between diversity and firm performance. Here, variable of investigation is ethnic diversity. Demographic diversity includes (ethnicity). Ethnic diversity can be measured through dividing total non-bumiputra by total board members on board. The dependent variable of this study is firm performance which can be measured market performance (market capitalization). The control variables of this study is board size. “Board size” refers to total number of directors on the board. This study will show the actual relationship between diversity and firm performance.

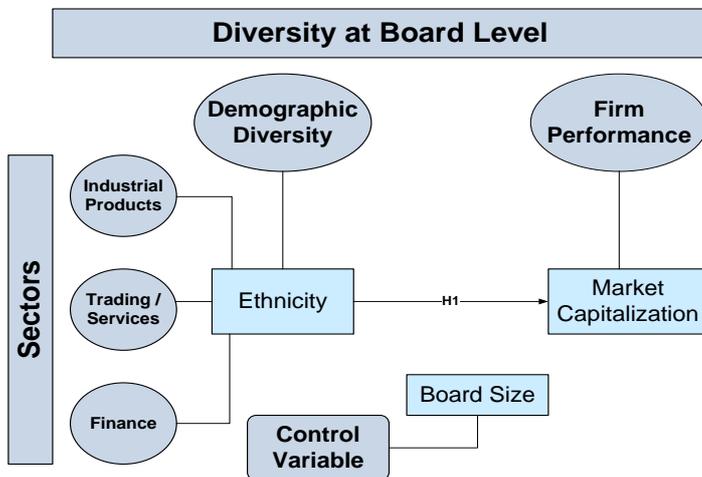


Fig.2. Theoretical Framework (Ethnic diversity at board level and its impact on firm performance)

5. INVESTIGATION OF ETHNICITY IN MALAYSIA

This study is specially designed to examine ethnic diversity trend among corporate boards of listed companies in Malaysia. A sample large 565 companies was considered based on total population of 965 companies. Total market capitalization was used to determine the size of companies. The sampling technique was judgmental in nature. The criterion was “total market capitalization”. A 5-year average market capitalization

used to measure the significance of the individual sectors. Therefore, three major sectors were identified they were Trading/Services, Finance, Industrial Products and numbers of companies each sector are 233, 43, and 289 respectively. As for data analysis, different statistical techniques used to illustrate the ethnic diversity among boards and market performance. Techniques are descriptive statistics, ANOVA, Correlation tests and graphical presentations.

5.1 Model of Ethnicity and Firm Performance

The modeling equation shows relationship between ethnic diversity and market performance. Board size is used as control variable. By running, the F-test (23.337) shows that there is a significant relationship between ethnic diversity and market performance at 0.05 as illustrated below.

$$\text{Market Performance} = \alpha + \beta_{\text{Ethnic Div}} + \beta_{\text{Board Size-CV}} + \epsilon$$

6. EMPIRICAL ANALYSIS AND DISCUSSION

6.1 Market Capitalization by Sector

The overall breakdown of market capitalization by sector in Fig.3. The total numbers of sector are thirteen. The leading sectors are Trading/Services, Finance and Industrial Products. The pie chart is giving us a quite interesting picture about market capitalization of each sector, how much every sector is contributing towards Malaysian economy. In this study, we focused three major sectors to examine the effect of ethnic diversity on boards with market performance. The rationale behind to choose these sectors, one is largest market capitalization and a good number of companies in these sectors which gives a good sample for analysis.

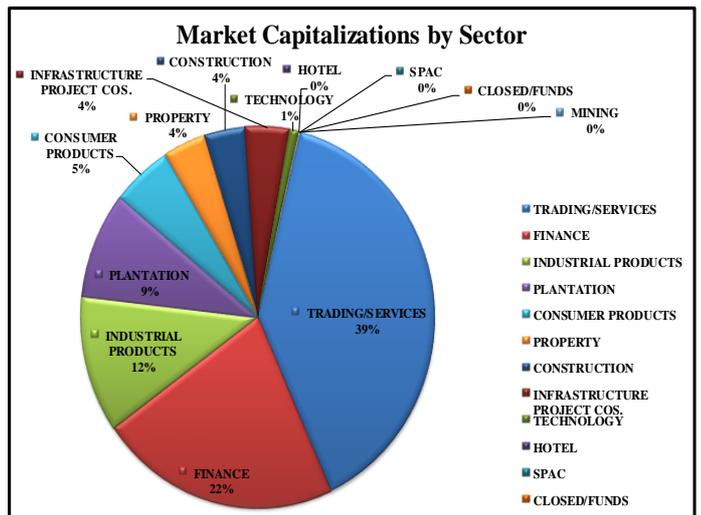


Fig.3. Total Market Capitalizations by Sector

Table.1 presents descriptive statistics of the three leading sectors in Malaysia based on market capitalization. These three sectors accounted for 565 companies listed on BURSA, Malaysia. The leading sector is trading / services with the largest market capitalization but proportion rate of non-bumiputara in industrial product sector was the highest.

Table.1. Summary of major sectors

No	No of Companies	Sector	Average Market Cap (Billion)	Proportion (%)	Board Size	Non-Bumiputra on Board	% Non-Bumiputra on Board
1	233	TRD./SRV.	1.95	37	1745	981	56.21
2	43	FINANCE	1.09	7	340	185	54.41
3	289	INDL PRD.	0.57	56	2053	1494	72.77
Tot	565		36.8	100	4138	2660	64.28

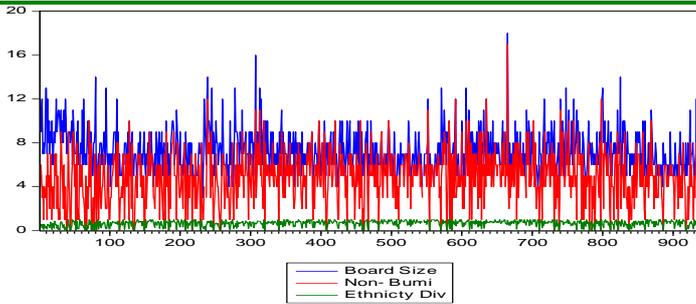


Fig.4. Graphical expression of Non- Bumiputra, Board Size & Ethnic Diversity

Fig.4. presents line graphs, which offer more insights whereas ethnic diversity fluctuates, board size also constantly fluctuate with some spikes and non-bumiputara presented in a descending order. Therefore, it can be concluded that there is a positive relationship between gender diversity and market capitalization. Fig. 4 involves data of all the 938 companies listed in BURSA, Malaysia.

6.2 Descriptive Statistics

Table.2. presents the descriptive statistics results of variables. The largest board size is 16 and a maximum non-bumiputara on a board is 12. The average of non-bumiputara at board level is 4.72. Sample is N = 565. The Kurtosis score of ethnic diversity is -.352.

Table.2. Descriptive statistics on market cap. & ethnic div.

	Market Cap.	Board Size	Bumiputra	Non-Bumiputara	Ethnic Div.
Mean	5.7862	7.33	2.61	4.72	.6504
Median	5.6500	7.00	2	5	.7100
Mode	6.23	7	1	5	1.00
Std. Dev.	.81046	1.939	2.330	2.322	.28540
Kurtosis	.809	1.019	.864	-.63	-.352
Range	5.11	14	11	12	1.00
Min.	3.32	2	0	0	.00
Max.	8.43	16	11	12	1.00

6.3 Graphical Expressions

The proportion of ethnic diversity among boards and to see the actual relationship of ethnic diversity at board level with market performance. Some graphical expressions are explained briefly and giving more insights about ethnicity at top-level management.

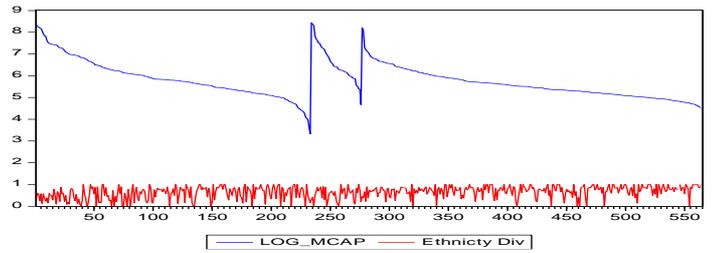


Fig.5. Line Chart Market Cap. Versus Ethnic Diversity

In addition, to see the trend of ethnic diversity with market capitalization, the line graph Fig.5. presents that as ethnic diversity fluctuates and market capitalization constantly fluctuates with spikes. Market capitalization presented in a descending order. It can be concluded that there is a positive relationship between ethnic diversity and market capitalization.

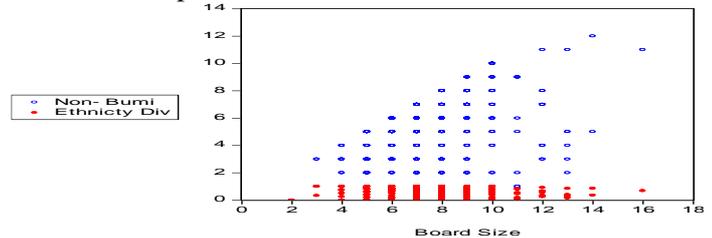


Fig.6. Scatter Dig. b/w Ethnic Div., Non-Bumi. & Bd Size

The scatter diagram Fig.6. presents that ethnic diversity which is more concentrated between 4 & 10 members on board. Companies' board size between 4 and 10 tend to have greater ethnic diversity.

6.4 Correlations Test

Table.3. Presents the results of correlation test. Market capitalization has a strong relationship with board size at 0.05 significance level. Ethnic diversity does have impact on market value but they are inversely correlated at 0.05 significance level. The results also indicate that the board size has a positively correlated with market performance. However, ethnic diversity is negatively associated with market performance which means greater the ethnic diversity at board level lower the market performance and there is no correlation between board size and ethnic diversity. It can be concluded that ethnic diversity does have an impact on firm performance. Hence, result of 2-Tailed is a negative statistically significant correlation between ethnic diversity and market capitalization.

Table.3. Correlations Results

Variables	1	2	3
1. Market Cap.	1	.433**	-.279*
2. Board Size		1	.034
3. Ethnic Diversity			1

** Correlation is significant at the 0.01 level (2-tailed).

* Correlation is significant at the 0.05 level (2-tailed).

6.5 One- Way ANOVA

Table.4. presents the results of One-Way ANOVA test. It can be concluded that there is a statistically significant difference among the three selected sectors with regard to market performance as represented by p-value (0.00) at 0.05. This signifies that there is a sector influence on market performance in the presence of the ethnicity.

Table.4. One-Way ANOVA: Ethnic Diversity Versus

Source	DF	SS	MS	F	P
Category	2	3.523	1.761	23.337	0.00
Error	561	42.417	0.075		
Total	564	45.940			

6.6 Post Hoc Test

Table.5. presents results that there is a significant difference between the two categories being compared. The Sig. value is less than 0.05.

Table.5. Post-Hoc results

Multiple Comparison		Dependent variable: Ethnic Div				
(I) Ctg.	(J) Ctg.	Mean Diff. (I-J)	Std. Error	Sig.	5% Confidence interval	
					Lower	Upper
Trading	Finance	.02155	.04560	.849	-.0904	.1335
	Industrial	-.15423*	.02419	.000	-.2136	-.0949
Finance	Trading	-.02155	.04560	.849	-.1335	0.904
	Industrial	-.17578*	.04490	.001	-.2860	-.0656
Industrial	Trading	.15423*	.02419	.000	.0949	.2136
	Finance	.17578*	.04490	.001	.0656	.2860

6.7 Regression Analysis

In addition, a bivariate regression test was conducted on the ethnic diversity with regard to market performance. The result shows that there is a significant negative relationship between ethnic diversity and market performance at 0.05 as illustrated below.

$$\text{Market Performance} = \alpha + \beta_{\text{Ethnic Div}} + \beta_{\text{Board Size}} \cdot \text{CV} + \epsilon$$

$$\text{Market Performance} = 6.30 - 0.681 \text{Ethnic Div} + 0.171 \text{Board Size} \cdot \text{CV} + 0.105$$

$$(* -6.502) \quad (**11.068)$$

Beta coefficient of ethnic effect is -0.681 (*t-value is -6.502) and beta-coefficient of board size effect is 0.171 (**t-value is 11.068) and the F-test (23.337) is very significant at 0.05. The results indicate that ethnic diversity does have impact on market value but they are inversely correlated. The results also indicate that the board size has a positive impact on market performance. However, ethnic diversity is negatively associated with market performance which means greater the ethnic diversity at board level lower the market performance.

7. LIMITATIONS OF THE STUDY

This paper only focuses on ethnic diversity (Bumiputara /Non-bumiputra) and large listed companies of Malaysia. In addition, this study incorporated only three major sectors (trading/services, finance, industrial products) and thus, it would be quite challenging to generalize the findings. However, these three sectors contribution is exceeding 50 percent of the total market capitalization.

8. CONCLUSIONS AND RECOMMENDATIONS

A more significant factor in corporate governance is relationship between board diversity and firm performance. Admittedly, ethnic diversity at board level does have impact on market value but they are inversely correlated. However, the results also indicate that the board size has a positive impact on market performance and reputation of firms. It also indicates that the proportion of non-bumiputra on boards tends to increase

with the increasing members on board. However, ethnic diversity is negatively associated with market performance which means greater the ethnic diversity at board level lower the market performance. Overall, results of this study provide evidence of a significant negative relation between market performance and diversity at board level. These results provides a quite interesting picture relating ethnic participation at top management level. It should be noted that only large companies seem too serious about promoting ethnic diversity at top level management. The most important thing is that ethnic participation really effect and matters in companies. Based on empirical findings, some recommendations can suggest for ethnic diversity among board level in listed companies of Malaysia. A mandatory proportion of ethnic diversity at board level should establish. Government and other regulatory bodies should ensure and make it necessary requirement for companies.

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