

The Integrative Effects of Board Diversity, Firm Reputation, and Innovation *vis-a-vis* Firm Performance

Yeo C. M. Amy^{1*} Cheang Esther² Felizia Arni Rudiawarni³

¹Faculty of Accountancy, Finance and Business, Tunku Abdul Rahman University College, Malaysia

²Securities Services Sdn Bhd, Bukit Damansara, Kuala Lumpur, Malaysia

³Faculty of Business and Economics, University of Surabaya, Indonesia

*Corresponding author. Email: yeocm@tarc.edu.my

ABSTRACT

A plethora of worldwide study on board diversity and its relationship with firm performance had produced mixed results. Our study investigated not only from the board diversity perspective, but also examined the integrative web of firm reputation and innovation as well as the shareholder activism. We employed Smart PLS and SPSS to run the 105-sampled data and the statistical findings suggested that firm reputation does boost firm performance but not innovation, and also there is a positive correlation between board diversity and firm reputation. The findings further posit that shareholder activism does indeed affect diverse representation of the board. However, it does not agree that shareholder activism itself has a positive correlation with firm performance. This could be attributed to the views of top-level management, directors, and company secretaries, who are more familiar with the nuances of the board *modus operandi* and functions.

Keywords: Firm reputation, innovation, firm performance, board diversity, shareholder activism

1. INTRODUCTION

Our society today is beaming with hopeful phases that shape and elevate a new manifestation of who we are and who we can be as a community. ‘Diversity’ is considered as a global landscape rooted in the heart of the real local communities, workplaces, and daily interactions, especially in a multi-racial nation like Malaysia. It cannot be denied that Board Diversity (BD) can improve policies and procedures while still understanding that diversity discrimination still exists [1][2][3]. Hence, it is fundamental for diversity inclusion to be a priority for organizations especially in Malaysia.

Gender as well as racial diversity, is underrepresented within the boardroom. This goes for age diversity as well, although there are efforts shown in allowing BD within an organization by having requirements within the legislations. For instance, within the Malaysian Code of Corporate Governance (MCCG) Practice 4.5, it recommends that at least 30% of the board consists of women. According to the Corporate Governance Monitor 2019, Malaysia has made slow but stable progress in improving gender diversity on boards. It was also reported in December 2018, that there was a 7% upsurge in women participation for the top 100 listed companies as compared to that in the year 2016. In the case for all listed companies, there was a 4% increase from the year 2016 to 2018.

However, it cannot be denied that some companies appoint diverse boards just for the sake of appointment [4][5]. Although it fulfils the requirement, however, the woman

had no professional knowledge or any ideas on the operations of business whatsoever. In the case of Malaysia, it was reported that in practice, although the MCCG codes are in force and requires the formation of audit committees on the board, these committees are in fact, ineffectual as there is a lack of representation as well as a lack of sufficient calibre. In addition, gender, ethnic, and age diversities among Malaysian firms are still very low. The researchers have reviewed that only 39% of the boards have women, and only 25% of the firms are considered ethnically diverse [1].

Many studies have shown that BD contributes to firm performance and organization overall value. However, there are also conflicting views that there is a negative or no relationship at all between BD and firm performance [6][7][8]. Henceforth, it is suggested to explore the mediating variables between diversity and performance in a more in-depth manner to uncover when and how diversity will affect firm performance [9][10][11], as the relationship between BD and firm performance is regarded as more complex and indirect [12]. Based on this line of contention, in our study, we therefore developed our research questions such as “how board diversity affects firm reputation and innovation?”, “Do firm reputation and innovation affects firm performance?”, and “how shareholder activism affects firm performance through board diversity?”

The research objectives of this study are as follows:

RO₁: To determine the indirect relationship between board diversity and firm performance.

RO₂: To investigate the role of firm reputation and innovation in mediating the relationship between board diversity and firm performance.

RO₃: To examine the relationship among shareholder activism, board diversity, and firm performance.

1.1. Hypotheses Developments

1.1.1. Board Diversity and Firm Performance

Several studies have associated that diverse board directly affects board performance. For instance, [13][14] research proved that a considerable gender-balanced board is more active in terms of board-level decision making such as taking initiatives and proposing actions to be taken [13]. Other additional studies have shown that BD does contribute to lower occurrences of earnings restatements and securities fraud [15][16]. Nevertheless, there are other researchers who have also challenged otherwise. For instance, a contradictory finding by [6] showed that there are nil relations between gender diversity and firm performance. From this perspective, there are researchers suggesting that due to the indirect relations between BD and firm performance, there are possible intervening variables between the two [9][10][2][11]. Thus, this study further explored the intervening variables which consist of shareholder activism and firm reputation, which may link BD and firm performance. Thus, we proposed the following hypothesis:

H₁: There is a positive correlation between board diversity and firm reputation.

In addition, this study also proposed that reputation functions as a crucial mediating variable which transmits the effect of diversity to firm performance, as prior researches also showed that reputation is positively associated with firm performance [17][18]. Thus, reputation should mediate the relationship between BD and firm performance.

H₂: Reputation mediates the relationship between board diversity and firm performance.

1.1.2. Board Diversity and Innovation

Prior studies have linked diversity to firm innovation. Many studies have proven that as homogenous groups tend to make bias decisions, a decision-making group which consist of diverse members from different cultural background or from different age groups, provides deeper and meaningful insights of which a homogenous group tend to overlook [2][19][20][21]. The extant theory has also been proven that gender, age, as well as racial diversity in the board assist in identifying new innovative opportunities. For instance, BD broadens the pool of evaluation of choices as there is a greater variety of ideas and perspectives present. Heterogeneous groups produce higher quality decisions than do homogeneous groups, and thus,

generating more innovative solutions than do homogeneous groups through cognitive conflict [21]. Besides, [22][23] suggested that heterogeneous managerial knowledge has a direct and positive impact towards innovation. Thus, it can be implied that there is a positive relationship between BD and firm innovation.

H₃: There is a positive correlation between board diversity and firm innovation.

Without denying the fact that innovation functions as a mediating variable which transmits the effect of diversity to firm performance, prior researches also showed that innovation is positively associated with firm performance [17][18][41]. Thus, innovation should mediate the relationship between BD and firm performance.

H₄: Innovation mediates the relationship between board diversity and firm performance.

1.1.3. Shareholder Activism and Board Diversity

Prior studies postulated that there is a positive correlation between shareholder activism and gender diversity of corporate boards of directors [24][25][26]. The study also suggested that shareholder activism acts as an effective mechanism in boosting female representations on boards [24]. It was reported that diversity resolutions have attained the highest average vote of 35.8% as compared to the environmental and social governance categories in 2013. There were several empirical evidences suggesting that the presence of female directors enhances the board's ability in monitoring firm managers, eventually leading to better board performance. Thus, such findings strengthen the studies suggested by [27], whereas the researchers found evidence in regards to women directors that exhibit higher likelihood of ethical sensitivity. There is a higher tendency for the firms to disclose their environmental reporting such as the participation in Carbon Disclosure Project, if they are targeted by environmental shareholder proposals [28]. Hence, with growing evidence in regards to the effectiveness of shareholders' activism and the ever-increasing focus on BD issues, there is a positive correlation between those two variables. Thus, it can be implied there is a positive relationship between shareholder activism and BD.

H₅: There is a positive correlation between shareholder activism and BD.

1.1.4. Shareholder Activism and Firm Performance

Shareholder's activism aids in minimizing conflicts as well as reducing undesirable behaviors of managers while at the same time, induces managers to achieve and commit to high-quality innovation strategies [31]. According to [32], it was also deliberated how managers would actually pay more focus on points suggested by large shareholders and

proactively pioneering latest technologies as well as investing in the firm’s Research and Development activities which promotes the development of new products (David, et al., 2001). Shareholder activism also plays a crucial role in reducing the agency costs of equity by closely monitoring action of corporate management [25]. Shareholder activism may promote better governance within a firm which in turn prevent corporate failure and promote sustainability. Moreover, it was also proven that shareholder activism generates corporate ethical and social responsibility performances [33][40]. Thus, the hypothesis is developed as follows.

Hypothesis 6: There is positive correlation between shareholder activism and firm performance.

The above hypotheses are depicted in the following proposed conceptual framework:

Proposed conceptual framework:

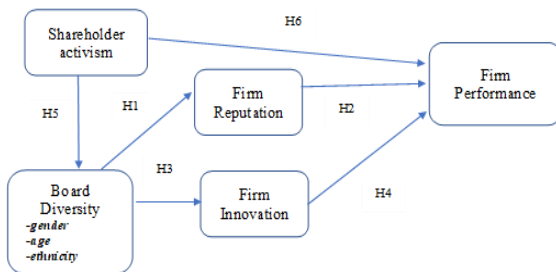


Figure 1 Proposed Conceptual Framework

2. RESEARCH METHODOLOGY

This research is based on a quantitative research approach followed by a descriptive cross-sectional study through the synthesizing of primary data mainly from questionnaire survey as it measures and quantifies the respondents’ opinions [29]. This study employed a structured questionnaire of collecting data. The coding and analysis as well as interpretation of data are based on SPSS (statistical package for the social sciences) and Smart PLS (Partial Least Square). Due to the current pandemic situation (Covid-19), the use of internet questionnaires is considerably preferred due to its several advantages which greatly outweighs its limitations. It is obvious that conducting surveys online requires the least total-time taken for administering the survey to the entire sample. There is a vast number of advantages of conducting an online questionnaire / survey which consist of the flexibility as they can be conducted in multiple formats such as emails with surveys attached-in, a URL link to the survey, social networks like LinkedIn, Instagram, Facebook, and so on. Hence, we managed to obtain a total of 105 usable samples from varied companies based in Malaysia. The survey measurement applied the 7-Point Likert Scales from “Strongly Disagree” (1) to “Strongly Agree” (7). Many studies have postulated that the 7-point Likert scale indeed supersedes the 5-point Likert scale. According to [30], the study used 7-category response scales were far much better than those using the 5-category scales as it allows not only

the measurement of direction and neutrality, but also assist the researcher to differentiate between the three levels of attitude intensity [30]. There are 2 sections in the questionnaire / survey, which consist of Section A and Section B. Pilot testing of the questionnaire / survey has been conducted for the purpose of improving the quality of the questions, as well as eliminating potential errors.

3. FINDINGS AND DISCUSSIONS

The findings have indicated clearly that the normality, common method variance, and multicollinearity test have met the required criteria to proceed with the remaining statistical analyses. We conducted a descriptive analysis on demographic profile and other characteristics of the 105 respondents. The majority of responses are males compared to females. Chinese respondents (67) constituted the higher percentage, and then followed by 27 Malaysian respondents and other minority. The age ranges from 20 to 35 years-old. 79% of the respondents have completed their Bachelor’s Degree, whereas 21% of them holds master or doctoral status. Furthermore, a majority of the respondents have less than 5 years of working experience. Moreover, a 43.8% of the respondents receives annual income ranges from RM 20,000 to RM 50,000 and a 24.8% of the respondents receives more than RM 100,000 per year. A majority of the respondents (72.4%) have 1 to 10 board members within their companies.

3.1. Path-Modelling Analysis (Direct Effect)

In testing H₁, we found that there is a significant and positive relationship between board diversity (BD) and firm reputation, whereas O = 0.588 with p-value of 0.000. This result can be translated that there is a positive correlation between BD and firm reputation. For H₂, there is a significant and positive relationship between firm reputation and firm performance, whereas O = 0.506 with p-value of 0.000. This result indicates that there is a positive correlation between firm reputation and firm performance. For H₃, there is a significant and positive relationship between BD and innovation, whereas O = 0.427, with p-value of 0.000. This result shows that there is a positive correlation between BD and innovation. For H₄, there is an insignificant and negative relationship between innovation and firm performance, whereas O = 0.146 with p-value of 0.095, which exceeds the threshold of 0.05. This testified that the hypothesis was not supported. For H₅, there is a significant and positive relationship between shareholder activism and BD, whereas O = 0.359 with p-value of 0.000. This can be translated that there is a positive correlation between shareholder activism and BD. For H₆, there is an insignificant and negative relationship between shareholder activism and firm performance, whereas O = -0.038 with p-value of 0.736, which exceeds the threshold of 0.05. This result can be translated that the hypothesis was not supported. (Refer to Table 1 below).

Table 1: Result of causal relationship with direct effect

				Original Sample(O)	P-values	Significance
H1	Board Diversity	(+)→	Firm Reputation	0.588	0.000	Significant
H2	Firm Reputation	(+)→	Firm Performance	0.506	0.000	Significant
H3	Board Diversity	(+)→	Innovation	0.427	0.000	Significant
H4	Innovation	(-)→	Firm Performance	0.146	0.095	Not Significant
H5	Shareholder Activism	(+)→	Board Diversity	0.359	0.000	Significant
H6	Shareholder Activism	(-)→	Firm Performance	-0.038	0.736	Not Significant

Notes:
 (+) = Positively related
 (-) = Negatively related

Table 2: Indirect effect of causal relationship between the variable

	INDEPENDENT VARIABLE	MEDIATORS	DEPENDENT VARIABLE	INDIRECT EFFECT	TOTAL EFFECT	P-VALUE	SIGNIFICANCE
H5	Shareholder Activism	Board Diversity, Firm Reputation	Firm Performance	0.107	2.760	0.006	Significant
H6		Board Diversity, Innovation		0.022	1.301	0.194	Not significant
H1	Shareholder Activism	Board Diversity	Firm Reputation	0.211	3.255	0.001	Significant
H3			Innovation	0.153	3.234	0.001	Significant
H4	Board Diversity	Innovation	Firm Performance	0.062	1.579	0.115	Not significant
H2		Firm Reputation		0.297	3.981	0.000	Significant

3.2. Path-Modelling Analysis (Indirect Effect)

We also tested the indirect effect of causal relationship between the variables. BD, firm reputation, and innovation became mediators, and shareholder activism as well as BD have indirect effect on firm performance. However, the indirect effect of the relationships between shareholder activism and firm performance (H₆) has a p-value of 0.194; BD and firm performance (H₄) has a p-value of 0.115, which both exceeds the threshold of 0.05, thus appears to be insignificant. Hence, there is no mediation between the aforesaid variables. For H₁, H₂, H₃, and H₅, all the four hypotheses were considered to be complementary-partial mediation. This is because p-values of the four hypotheses, in both direct and indirect effects, are significant based on the path-modelling analysis conducted through Smart PLS. There were 6 hypotheses tested in total. The findings from this study have failed to support the two hypothesised relationships, one of which include the one suggested that innovation mediates the relationship between BD and firm performance (H₄). The other one that was not supported, described that there is a positive correlation between shareholder activism and firm performance (H₆). Interestingly, the results have confirmed that the other 4 hypotheses (H₁, H₂, H₃, H₅) have positive relationships. In this study, it can be proven that a considerable diversity within the boardroom would contribute to firm reputation. Thus, the results are consistent with other prior-studies which suggested that a company may portray a positive message to public at large, when there is a higher proportion of diversity within a board's structure. As the findings suggested, the reputation functions as a significant mediating variable which transmits the effect of diversity to firm performance, as this is consistent with other studies [17] [2]. The results, therefore, show clearly that reputation is an important mediator in allowing a firm to perform well through increasing diversity in the board. In other word, in order for board diversity to boost a particular firm performance, reputation plays an important role in achieving such positive results (Refer to the Table 2 below).

This study also revealed that the results support the linkage between board diversity and firm innovation. This study postulates that gender, age, as well as racial diversity in the board, allows for new innovation ideas to flow within the boardroom. Thus, this broadens the pool of evaluation of choices as well as widens the range of perspectives. In the same vein, previous studies also unfolded that a decision-making group, which consist of diverse members, provides greater insights as compared to a group that do not have diverse members [2] [19] [20] [21]. Prior researchers have postulated that innovation is positively associated with firm performance (Caves & Ghemawat, 1992; Nelson & Winter, 1982). Miller and Triana posit that innovation functions as a mediating variable which transmits the effect of board diversity to firm performance. However, the mediation effect of innovation was tested with insignificant results (H₄). Hence, it can be conjectured from this analysis that some of the directors and company secretaries may not agree that board diversity boost firm performance through innovation.

Our study also found that shareholder activism acts as an effective mechanism in increasing diverse representation in the board, which supports various studies conducted by [24] and [25]. Besides, several studies have also posited that shareholders' concerns in regards to social issues would urge the firm to participate and disclose their environmental reporting, once the firm is targeted by environmental shareholder proposals [38] [28]. By this way, with the ever-increasing focus on BD issues, it can be postulated that there is growing evidence of shareholders' activism effectiveness in increasing BD within a particular firm. Previous research suggested how shareholder activism could urge managers to make innovative decisions as well as investing more in research and development within the company [31] [39] [25]. Shareholder activism also aids in minimizing corporate failure through the promotion of sustainability as well as generating social responsibility performances [25] [33]. However, despite such contention, our findings indicated that shareholder activism does not have an effect on firm performance. This could happen due to the fact that some directors and company secretaries believe that shareholder activism does not have a significant effect on the firm performance outcome.

4. CONCLUSIONS

The aim of this study was to observe the intervening variables which indirectly affect firm performance from BD perspective. It was also argued within this study that shareholder activism acts as a mechanism in allowing BD which also indirectly affects firm performance. Hence, the findings have supported this study as BD indeed has a significant impact towards a particular firm performance indirectly. This study managed to find evidence that BD has an indirect effect towards firm performance through reputation. Furthermore, it was also proven that BD does increase innovativeness within a company. However, it does not support the phenomenon which innovation acts as a crucial mediator in BD and firm performance relationship. The results serve as a cornerstone for board members and other top-level executives to re-assess the board diversity in terms of gender, ethnicity, and age; to prioritise the firm image as an essential attribute and emphasize on firm innovation as a touchstone for increased economic returns and value creation.

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