

Analysis of relationship between board diversity and corporate performance

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In view that corporate performance may be influenced by corporate governance and the diversification of Board, this Memorandum is submitted to the Board of Directors for clarifying concerns regarding the above subjects.

This Memorandum is structured as following: (1) Statement of the Facts; (2) Argument; (3) Conclusions & Recommendations. 1. Statement of the Facts Following from the last Board meeting that held on 8th February, 2013, one of our directors, Mr. John argued that greater attention on corporate governance is important to our company as our company is a listed multinational retailer company and desperate to expand the business throughout all of Africa. Mr. John also mentioned that, in a long term view, more diversified Board may be able to enhance shareholder value.

However, Mr. Fuad, another director has pointed out that there is no evidence to proof Mr. John's statement, whereby gives more attention to corporate governance (CG) and more diversified Board would enhance shareholder value. (a) Problem 1: Greater attention to corporate governance helps corporate performance? When a company is governed by using systems, principles and processes which are the guidelines for a company to operate or control to achieve the company's mission, vision and objective, it will be called as corporate governance.

While the company trying to achieve the goals and objectives, it will be part of the process to improve company's value and benefits to all the stakeholders in long term. " The stakeholders for corporate governance are board of

directors, management, shareholders to customers, employees and society. The management of the company hence assumes the role of a trustee for all the others," (Thomson, 2009). Therefore, King II Report, which published by Committee on Corporate Governance, South Africa in year 2002 has identified the seven distinguished characters of being good corporate governance (Mallin, 2013).

According to (Mallin, 2013), the characteristics are consists of " discipline in the context of proper and appropriate behaviours, being transparent to investors, being independent to ensure there are no conflicts of interest at board or management level, accountability of decision-makers for their decisions and actions, management responsible for their actions and correct inappropriate actions, fairness for every parties in the company, and performing socialresponsibilityto be a good corporate citizen by giving high priority to ethical standards. " (i) Discipline

As per stated (Zinkin, 2009) in The Star Online, self-discipline, market discipline and regulatory discipline are the three disciplines of effective corporate governance. These disciplines are often be talked by Datuk Seri Panglima Andrew Sheng and Datuk Seri Zarinah Anwar, chairman of Malaysia Securities Commission due to they believe these disciplines are required for good CG. Self-discipline is included the personal integrity and good business judgement. According to (Zinkin, 2009), there are no correct " Tone at the Top" if there is no personal integrity. Without the right " Tone at the Top", all business decisions run the risk of being undermined by personal gain at the expense of the company, or even society as a whole, as we have seen only

too clearly in the current Wall Street disasters,” (Zinkin, 2009). Then, good business judgment helps the Board to prevent from making any wrong decision. The Board able to understand the overall company’s risk profile before making a decision. “ Market discipline is the result of the willingness to invest in company, effected in companies’ market capitalisation and social sanctions for bad behaviour,” (Zinkin, 2009). When a company is found to be guilty in poor CG and fail in strategy, this company will be destroyed by the market, such as Lehman Brothers, which bankrupted in year 2008. Regulatory discipline is “ designed to stop intermediariescheatingthe public and protects the innocents from scams. It also penalises lack of transparency and malpractice, when it can be proved,” (Zinkin, 2009). (ii) Transparency

NAPF has stated that there are more shareholders started to concern about the pension perks of the company’s top executives. “ The investors warned that a lack of transparency around boardroom pensions is an obstacle to shareholder scrutiny, and that generous pensions risk rewarding bosses for poor performance,” (NAPF, 2010). As per Lord Myners, the former City minister, said “ allowed non-executive directors to hide behind ever more complicated remuneration formulae, rather than requiring them to exercise some judgment of their own,” (Prosser, 2011). iii) Independence Griesedieck & Nahas stated that “ Director Candidates who meet independence and professional capacity requirements are harder to find, and competition for qualified, individuals is fierce. ” Therefore, “ it’s a key role of the chairman to have aculturewhere the ‘ big dumb’ questions on risks and opportunities can be asked,” said Sir Philip Hampton, chairman of the Royal Bank of Scotland (Financial Times: Non-Executives Need To Find A Voice, 2012). In addition, in

order to remain the independency in boardroom, Independent. e stated that “ it is important that the board appoints someone with an extensive breadth and depth of executive experience and who possesses strong communications and interpersonal skills. ” (iv) Accountability According to Activism, “ In 2009, Microsoft announced that a shareholder with 25% of the company shares can call a special meeting” to maintain the company’s strong corporate governance practices. However, it is more realistic and attainable to change from 25% to 5% as the standard for calling a special meeting by a shareholder, due to the high value of stock price.

In this view, when a company’s decision makers would like to be accountability, he or she may need to fit his/herself in shareholders’ shoes on whether there is a possibility to meet the standard. Failure to do so, will caused dissatisfaction from shareholders which may affects the company’s reputation and indirectly gives an impact to company performance. According to Lerach, “ Corporations are overseen by boards of directors, but accountability to shareholders has long been overtaken by insider control and deference to management.

Attempts by investors to improve corporate governance have produced only cosmetic improvements. ” This statement shows that the accountability to shareholders is not high enough. (v) Responsibility It is important for every management to be responsible for their roles, actions and behaviour. However, it is not easy to fulfil the responsibility 100%. Example, many of the UK boardrooms is having the same problem, whereby there are “ silent” non-executive directors, who does not challenge any strategy and ideas that

proposed, does not share opinions or no discussion at all during the board meeting. vi) Fairness Lucy P. Marcus mentioned that the world is quite strict to the companies that may be failed in performing the business with a global standard of ethnics and fairness. It has been proved by referring to the case of Foxconn and Apple. (vii) Social Responsibility (CSR) GIZ stated that within the concept of CSR, " companies consider the interest of society by taking responsibility for their impact of their activities. It promotes both the integration of social, ecological and governance aspects into business strategies and operations and engagement in collective action in support of sustainable development. " It means other than concern on company's profit; a company have to pay attention to people and planet. According to Dogterom, there is a research shows that " paying attention to people, both inside and outside the organization, and caring for the planet are just as necessary for the continuity of enterprises. " " In 2010, the average economic growth rate of Africa across the continent has overtaken both Brazil and India," (Forstater, et al. , 2010).

However, 80% of Africans earn equal or less than US\$2 per day. Some companies from China, Japan, the UK and US contribute in CSR by having some volunteering program on health living, education, development. There are not much information shows that there are any CSR performed by local companies in Africa. (b) Problem 2: More diversified Board able to enhance corporate performance? (i) Gender Diversity A survey, (Catalyst, 2012), shows that there are 45. 2% women of South Africa are working, but only 15. 8% of the Directors are female. The proportions of both statistics are not balanced.

Source: (Catalyst, 2012) Source: (Catalyst, 2012) (ii) Ethnic Diversity There are more than 20 ethnic groups in Africa (included all Africa countries). When Africa being independence, “ most African were thought to be in the process of becoming ethnic groups and living in plural societies where cultural differences would be accepted. But, it does not happened,” (Clay, 2010). By referring to Clay’s statement above, it may be difficult to have diversification of ethnics in boardroom of a company in Africa, with such a large numbers of ethnic groups.

However, “ the solution is not to give up and avoid diversity. Rather, boards need to minimize the friction that diversity often introduces,” (Manzoni, et al. , 2012). 2. Argument (a) Argument 1: Evidence on greater attention to corporate governance helps corporate performance. Even though section 1: Statement of the Facts shows that there is still some doubts on the relationship between corporate governance and corporate performance, however, there are some statements support Mr. John’s statement: According to (Financial Reporting Council, 2012), the UK market is attractive to new investment.

It is due to there are some world’s highest standards of corporate governance in the UK. Therefore, (Financial Reporting Council, 2012) stated that “ high quality corporate governance helps to underpin long-term company performance. ” As per the survey that performed by (Felton, et al. , 1996), two-thirds of the investors are willing to pay more for stock if the company is well governed. The survey also shows that portfolio turnover,

asset management philosophy and client base are the key factors that affect the investors' decision.

The reasons that investors care about good CG are: Good CG will perform better after certain of time, then stock price may increased; the company will be riskless to do bad things, if there are something wrong has happened, with a good CG, the company able to faster rebound; and CG is gradually becomes a hot topic. In fact, a survey reveals that institutional investors are willing to pay approximate 28% more for the company that has good CG in emerging markets of Malaysia, India, South Korea, Turkey, Taiwan and Mexico (Coombes & Watson, 2000). Newell & Wilson, 2002) A report stated that "...companies with better corporate governance did have higher price-to-book ratios, indicating that investors will pay a premium for shares in a well-governed company. " This report also shows that there was an increment of 10% - 12% in market valuation of the sample companies, when these companies have a better CG. (b) Argument 2: Evidence on more diversified Board able to enhance corporate performance. (i) Gender Diversity

As per the New York Times, " women have been appointed to the Saudi Council for the first time, the traditionally all-male body which drafts laws, debates major issues and provides advice to the king," (Hamdan, 2013). By referring to the dramatical changes of Saudi Arabia's politic structure, which was previously seems to be very difficult to have a female representative in political workforce; there is a possibility to have gender diversity in any African company's boardroom. It is just a matter of " Correct Time, Correct

Place, Correct Person” (Chinese proverb: Tian Shi, Di Li, Ren He). A gender-diverse board of directors and senior leadership team (C-suite) will help corporations lead and manage sustainable, effective business strategies, role model employee opportunities, and enhance their reputation,” (Catalyst, 2013). The above statement can be proved by referring to the below statistics, whereby if there are at least three women that serve in the boardroom, the ROE, ROS and ROIC can be achieved higher than the average percentage. Source: (Joy, et al. , 2007) Source: (Joy, et al. , 2007)

The table above shows other than Financial and Material Industries, basically, WBD helps in gaining a better corporate performance. ii) Ethnic Diversity According to Chicago Tribune Business, even though many corporations realised the importance of having diversification, but a survey has shown that “ many corporate boards have failed to adequately represent the makeup of the broader population” (Bomkamp, 2013). The reasons of having such results are the members of Board are mostly selected from a “ small pool of network connections” and they tend to avoid getting members who may have different view-points and different culture backgrounds.

In the same article, Maria Green mentioned that “ the diversification in a company’s business units and brands allows it to balance market uncertainties”, so she believes that by having a diversification in boardroom will helps to broaden the company’s world view and gotten a better strategic direction. Arciniaga, the managing partner of Advisory Board Architects (ABA), stated that ABA believes “ diversity can be good; however, diversity by itself is not a prerequisite to having a great corporate board, a great board experience or a great organization. ABA strongly believes that only by

having suitable subject matter experts who are equipped with right or related qualifications and experience can contribute in the boardroom and help the company performance. 3. Conclusions & Recommendations (i) Conclusions The board meetings are playing a significant role in corporate governance and corporate performance (Lipton & Lorsch, 1992). Failure to have good corporate governance will lead to a failure of business performance and the credibility of board of Directors, which can be witnessed by referring to the falling of Enron.

The diversification of gender and ethnics in Boardrooms can help the corporate performance, however, it is a must to ensure that the Directors are not selected with the purpose of ' seat-filling', but have to ensure that they are well-equipped with rich working experience in related industry and meet the qualification. A careful filtering process is required before the any one joins the Boardroom. (ii) Recommendations Felton et. al, stated that "... it remains clear that good board governance can serve as a tool for attracting certain types of investors, as well as influencing what they will pay for stock. Longstaff mentioned that " whatever the case, there is a need for there to be greater attention given to the task of finding ways in which directors can express their understanding of their accountability to the shareholders. A good first step might involve large public companies in setting an example by recognising that their annual general meetings should be an opportunity for the free exchange of ideas, questions and comments amongst and between directors and shareholders. "

It may be difficult for performing better corporate governance in Africa, however, giving more attention on corporate governance will improve TopCo's business performance. By referring all the benefits that mentioned above, it is highly recommended that TopCo's Board of Directors to perform better corporate governance and have a diversification of gender and ethnics in Boardroom. Bibliography Activism, T. C. G. , 2009. No Accountability in The Boardroom. [Online] Available at: <http://thecrandreagoupr.blogspot.co.uk/2009/06/no-accountability-in-boardroom.html> [Accessed 03 03 2013]. Arciniaga, B. , 2013.

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