

CHAPTER I

INTRODUCTION

1.1 Background

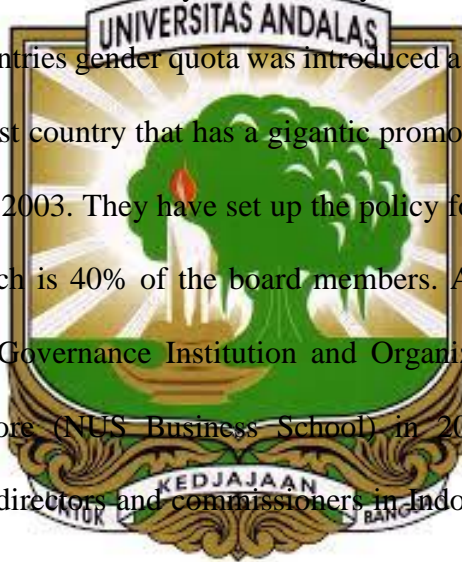
In the last few years, board diversity has become a global phenomenon in today's business entities. As an emerging issue in Corporate Governance, board diversity becomes one of the important categories to set up the rules for the board composition. As the result, many companies are attracted to set the policies for diversity at the top management level. The board group with greater diversity have a tendency to perform better rather than a homogeneous groups (Ernst & Young, 2009) and if it is managed properly it will help the management to produce more innovative business decisions (Catalyst, 2006). This is also supported by a study from Thomas and Elly (1996). They state that the well-managed diversity and smart companies that diversify their board can lead to more innovation, independence, and good governance. It also can help a company to maximize their performance.



According to a research from Van Der Wald and Ingley (2003), board diversity is different composition of board and the varied combination of attributes, characteristics and expertise contributed by individual board members in relation to make a decision. There are several types of diversity in boardroom such as age, gender, ethnicity, culture, religion, constituency representation, independence, professional background, knowledge, technical skills and expertise, commercial

and industry experience, career and life experience (Milliken and Martins, 1996). The increase of diversity can offer corporations several number of benefits such as improving the decision quality, additional knowledge, fresh ideas and insights to assist problem-solving, better product positioning, increased strategic planning, new knowledge or perspectives, and also additional accountability (Arfken et al. 2004)

There is no consistent answer found about diversity on board. It has a mixed result in many levels. Gender diversity is most likely to be studied by scholars. This is because in some countries gender quota was introduced as well as the importance of it. Norway is the first country that has a gigantic promotion of gender diversity which is applied since 2003. They have set up the policy for women proportion in public companies which is 40% of the board members. According to a research from The Center for Governance Institution and Organization of The National University of Singapore (NUS Business School) in 2012, it shows that the percentage of women directors and commissioners in Indonesia is 11.6% and this is lower than Europe (17.0%), North America (16.1%) and Australia (13.8%); but compared favorably to other emerging markets, which on an average have 7.2% women on their boards. There is a significant phenomenon of women in top management roles in different developed and developing countries (Ye et al. 2010). According to a research from Hilman et al. (2007), women on board can bring different perspectives and experience to the boardroom which can improve the board decision quality and lead to a better performance. This is supported by research from Smith et al. (2005). They observe 2500 largest Danish firms during



1993 - 2001 and find that the proportion of women on board tends to have a positive effect on company performance. Meanwhile, a negative result found by Darmadi (2011) that women representation is not associated with the improved level of company performance. The variety of result exist because there is an influence of different national culture (Scheppink, 2018) and differences in industry and company culture (Arfken, 2004).

The other demographic factor that will be considered is nationality diversity. This study is overlooked and just a little few are published. The involvement of foreign board members can help the company to expand the business globally because board members from different nationality have knowledge of their home country and have a strong connection with the social and political circle in their country. Director nationality may be a critical factor in how the interests of the various stakeholder groups are played out in the corporate arena and as well as their existence might influence the quality of decision making (Estelyi and Nisar, 2016). It is supported by a study from Rodrigues (2014) which showed a positive correlation between nationality diversity and company performance.

Diversity in boardroom is also reflected on the age of board members. Although this is not studied a lot, the presence can impact on the company performance. A diversity of age is expected to be able to increase the variety of perspectives of board members on the strategic issue facing a firm (Wiersema and Bantel, 1992). People of different age bring different experiences and different point of view to the boardroom. There are some reasons why diversity of age is



important. First, in an organization the younger individuals have the willingness to take the risk and tend to become more receptive to the new changes (Wiersema and Bantel, 1992). Second, they are more creative in way of thinking and help the company by providing the new energy and innovative ideas (Beaver & Hutchings 2005). Meanwhile, older individuals have a tendency to avoid the risk (Miller, 1991) but they have more experience in the industry (Beaver & Hutchings 2005). It is align with a study from Dagsson (2011), he finds that diversity of age significantly affects firm performance as measured by ROA. While a study from Darmadi (2011) shows there is not significant influence on company performance.



Based on Law of the Republic of Indonesia No. 40 year 2007, the corporation in Indonesia adopts two-tier board system which follows the idea of an organizational separation of management and supervision which consist of a Board of Commissioner (BOC) and Board of Director (BOD). The members of BOC and BOD are going to be selected in the shareholder's general meeting. BOC is fully responsible to supervise the implementation of policies and to give advice to the BOD. The Board of Director, as well as the BOC has an important role in implementation of corporate governance. BOD has a responsibility to manage the company and make strategic decisions as well as to determine how effective to run its function.

The Government has not provided a guideline yet for proportion of diversity in the boardroom that can be used by the corporation. Although there is no guideline that force the company to be more diverse, it seems that company is aware if

diversity is something that can be considered to improve financial performance. Performance is a description of the implementation achievement of an activity (Wardhani, 2006) and it can be done in many ways.

The objective of this study is to investigate the relationship of board diversity on company performance. It will consider the demographic diversity such as gender, nationality and age diversity and will be measured by Return on Asset (ROA) and Return on Equity (ROE) as to measure accounting-based performance, while to measure the market-based performance, it will be used Tobin's Q. In investing activities, an investor uses ROA and ROE ratios to become a benchmark for choosing stocks. ROA is a measurement of performance, because it looks at how management is able to utilize their assets into company profits. Whereas ROE is a measurement of the company's performance that it will be a benchmark for how much they will get rewarded for the invested capital. Tobin's Q ratio is a measurement of the market value of a company in relation to its assets. This measurement has been used by Salim Darmadi (2011) and Diepen (2015). There are some considerable number of studies that examine the relationship of board diversity on performance that can support this study such as Darmadi (2011), Diepen (2015) and Rodrigues (2014).

This study will observe 280 manufacturing companies and 89 banking companies listed on Indonesia Stock Exchange. Manufacturing companies are companies that use parts or raw materials to make a finished good and its capital come from share issuance, lent from a bank and from the third party. The reason to



choose manufacturing companies is because it has the highest average share price growth compared to other sector companies listed in Indonesia Stock Exchange (IDX), so it can be concluded that the manufacturing companies are a group of industrial companies that are growing rapidly in business activities. The manufacturing sector is also the most registered company and most active in trading its shares. While according to Law of Republic of Indonesia No 10 year 1998 Article 1 paragraph 2, banking is a business entity that collects funds from the public in the form of deposits and distributes it to the community. The reason to choose the banking sector is that banking stocks are one of the stocks that investors are interested in investing, because the sector has growth potential and produces good future profits as the economic growth in Indonesia that keep increasing. They both have an important role in the financial system and to boost the economy in Indonesia.



1.2 Problem Statement

1. Do the presence of woman in Board of Commissioner and Board of Director have a significant influence on the performance of manufacturing and banking companies?
2. Do the presence of foreign board members on Board of Commissioner and Board of Director have an influence on the performance of manufacturing and banking companies?
3. Do the presence of age diversity on Board of Commissioner and Board of Director have an influence on the performance of manufacturing and banking companies?



1.3 Research Objectives

This study aims to:

1. To investigate whether there is a significant different of performance between company that have women representation and don't have women of Board of Commissioner and Board of Director in manufacturing and banking companies.

2. To investigate whether there is a significant different of performance between company that have foreign board members and don't have foreign members of Board of Commissioner and Board of Director in manufacturing and banking companies.
3. To investigate whether there is a significant different of performance between company that have young board members and don't have young board members of Board of Commissioner and Board of Director in manufacturing and banking companies.

1.4 Study Benefit

1. Investors

This study will be useful for investor as a consideration in making an investment decision by looking at the characteristic of the board diversity.

2. Companies

This study expected to give a new insight for companies to provide more opportunities for women to get on board that helps to achieve companies objective by given the same opportunities as men to work for companies future, and to widening the opportunities for foreign director to work in the company.

3. Regulators

This study will give ideas for the regulator to create a future policy to the nation like proportion or diversity quota to work in top management.



4. Academics

Academically this research provides benefits to the development of science in the field of Corporate Governance. This research is expected to be a material for readers from academic to broaden the insight and development of research related to board diversity and company performance

5. Future Researcher

This research is expected to be useful for the future researcher. It will give an insight and reference for the research on the influence of board diversity to manufacturing and banking performance

1.5 Writing Systematic

Systematic of writing this thesis will be arranged in five chapters. The first is introduction that explains about the background, problem formulation, research purpose, benefit and writing systematic. Second, Literature Review will explain about agency theory, board of commissioner and board of director, corporate governance, resource dependence theory and upper echelon theory, board diversity, company performance, and review of the previous researches to develop the hypothesis. Third is research methodology that explains about research design, population, sample, data and methods of data collection, measurement of research variables and method of data analysis. Fourth is analysis and result will explain about the result of the hypothesis testing, so it can answered the problem. The last is conclusion, research limit and opinion, and the implication of research that has been done.

