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Board diversity and corporate expropriation

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Abstract

This paper provides evidence on the role of board diversity in dealing with corporate expropriation of listed companies in Malaysia. Diverse boards become important tool in corporate governance by providing board heterogeneity and effective monitoring that would enhance boardroom discussion and promote quality governance in the firms in order to lessen the possibility of expropriation. This study makes use of women on board, foreign directors on board and board tenure to describe the diverse boards. Though there is a positive relationship between women on board and corporate expropriation, the result is insignificant. It is evident that there is a negative relationship between foreign directors and corporate expropriation. Meanwhile, board tenure shows an inverse relationship with corporate expropriation.

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Keywords: Corporate governance; corporate expropriation; board diversity

1. Introduction

Expropriation can be defined as an illegal removal of asset, wealth and profit especially by controlling shareholders using their power of control in the firm at the expense of other shareholders, for their own benefit (Shleifer & Vishny, 1997; Singhai, 2002; Sulong & Nor, 2008). Basically, there are various forms of expropriations such as profit expropriation, tunneling of assets and improper dilution of ownership (Singhai,

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2002), related party transaction (Harto, 2012) and inefficient investment in a concentrated ownership structure (Shleifer & Vishny, 1997; Sulong & Nor, 2008).

Denis and McConnel (2003) define corporate governance as a set of mechanisms, involved in organization's decision-making with the objective to maximize the organization's value and to increase shareholders' wealth. Thus, every action and decision taken by the company is intended to provide benefits to all shareholders of the company. This is the same as those expressed by Shleifer and Vishny (1997), where "corporate governance deals with the ways in which supplier of finance are assured of getting a return on their investment". This view is more specific in explaining the possibility of expropriation and the role of board of directors in protecting the shareholders' interest. This is brought up by Claessen (2006) with the argument that corporate governance is related to the role of multiple shareholders and board of directors. The role of the board of directors is considered to be an important mechanism in dealing with corporate expropriation. Hopewell (2009) states that among the factors that lead to the collapse of Lehman Brothers in 2008 is the problem of the board of directors. He revealed several weaknesses that need attention such as the performance of the board of directors and the failure of the composition of board in terms of directors' skills, experience and independence status.

Diverse board becomes important tool in corporate governance by providing board heterogeneity and effective monitoring that would enhance boardroom discussion and promote quality governance in the firms in order to lessen the possibility of expropriation. As most of board's studies directed towards understanding the influence of its structure on firm's performance, this study is intended to examine the relationship between board diversity and corporate expropriation.

2. Literature review and hypothesis development

2.1 Agency Theory

The original concept of agency problem was initiated by Berle and Means (1932). The authors addressed the concept of agency theory and applied in the large corporation. It became popular among researchers during 1960's and early 1970's who address the problem of risk sharing between two parties that have different perception on risk (Eisenhardt, 1988). The main issue raised in the agency theory is the divergence of interest between principal and agent. According to the theory, this divergence can be minimized by giving appropriate incentives to the agents and to monitor on every action made by agents (Jensen & Meckling, 1976). Agency theory has been widely used in the fields of economics, finance, marketing, political science, organization behavior and sociology.

Berle and Means (1932) discuss the agency theory on relationship between principal and agent. The principal authorizes the agent to represent him/her with certain pre-determined conditions. In general, agency problem is a common phenomenon in any firm when there is a separation of ownership and management. The basic form of a firm comprises of three distinct groups, namely shareholders who control the firm regarding the direction, policies and activities of a firm; board of directors who are elected by shareholders; top management who are appointed by the board of directors. The effect of board on the various corporate financial policies is vital due to the linkage between shareholders and directors since the board of directors is elected by the shareholders. Notably, the board of directors is the highest governing authority in the management structure of a public listed company.

Dividend payout has been used by the earlier studies as a measure of corporate expropriation. Adjaoud and Ben-Amar (2010) propose that dividends are used as a tool to shrink the agency costs of free cash flow as well as to protect shareholders from expropriation. La Porta et al. (2000) suggest that there should be positive relationship between corporate governance quality and dividend payout because firms with better-governed will ensure the best protection for their shareholders. Thus, shareholders have the power to pressure management to distribute higher dividends rather than expropriate the excess cash for their private benefits (La Porta et al., 2000; Mitton, 2002).

2.2 Board diversity

2.2.1 Woman on board

Past studies on gender postulate that a positive relationship between woman on board and firm's performance (Erhardt et al., 2003; Catalyst, 2007; Adam & Feirreira, 2009). Previous studies also documented that presence of women on the board would enhance the independence of the board (Fondas & Sassalos, 2000), play a role to contribute to enhance quality of governance in boardroom by providing different point of view in discussion and make a board more interactive (Ruigrok et al., 2007), more concentrate on their role by avoiding political behavior that lead to enhance the efficiency of board (Sing et al., 2008). Therefore, women on board would bring a lot of benefits to the shareholder and seem to alleviate the possibility of expropriation by providing their role effectively in the boardroom. As expropriation is expected to be reduced in the presence of women on board, it is hypothesized that: H1: There is a positive relationship between the presence of women on the board and dividend payout.

2.2.2 Foreign board member

Another dimension of board diversity is nationality and tenure of the board of director. The presence of foreign board improved firm's performance due to monitoring function carried out by them and making the board to be more independence by reducing the expropriation and restrict the power of existing board members (Oxelheim & Randoy, 2002; Choi et al., 2007), foreign board has been identified as significant part of corporate governance (Choi et al., 2007) and foreign board bring diverse opinion and views, professional experiences and different thinking, and heterogeneity (Ararat et al., 2010). As expropriation is expected to be reduced in the presence of foreign, it is hypothesized that: H2: *There is a positive relationship between the presence of foreign board and dividend payout.*

2.2.3 Board tenure

Long board tenure makes the board members more mature and will influence decision making. With their vast experience, they are better directing policies of the firm (Vafeas, 2003; Liew et al., 2011). It also enhances of the effectiveness of the monitoring especially on financial reporting (Liu & Sun, 2005). In addition, director tenure is determinant of director quality (Vafeas, 2003). Therefore, expropriation is expected to be reduced in the presence of board with long tenure. Thus, the following hypothesis is developed: H3: There is a positive relationship between board tenure and dividend payout.

3. Methodology

3.1Variables

3.1.1 Dependent variables

In this study, expropriation is primarily measured by dividend payout that is the total dividend paid to preferred and common stockholders. The data variable is directly computed from balance sheet of the company. There are several past studies that have employed dividend payout as a measure of dividend policy such as Pindado and Torre (2006), Mancinelli and Ozkan (2006), Thomsen (2005), Cronqvist and Fahlenbrach (2009) and Ghachem (2008). This study follows the dividend measure defined by Facio et al. (2001) by computing dividend to sales ratio, where sales are net sales.

3.1.2 Independent variable

Women on board: Numbers of women on the board has been employed to measure the presence of woman on the board (FEM). This measure which is also applied in this study has been commonly used in prior research (Kramer et al., 2007; Ruigrok et al., 2007; Carter et al., 2008; Buniamin et al., 2012).

Foreign board: To measure foreign board (FOR), this study used the number of foreign director who sit on the board.This measure has been widely used by prior studies (Choi et al., 2007; Ruigrok et al., 2007; Ararat et al., 2010; Schwizer et al., 2012).

Board tenure: The tenure of director (TENP) is measured by the percentage of directors whose tenure is equal or greater than to 8 years. This measurement is used in board independence studies by Vafeas (2003) and Sharma (2011).

3.1.3 Control variable

Firm Size: In this study, firm size is employed to control the size effect. It is because of the possibility that the size of the firm will affect the dividend policy. Sulong (2008) argued that larger companies have better growth opportunities and access to financing opportunities, less information asymmetry due to availability of information, wider share spread and ownership profile. Pandey (2002) reportes that firm size has a positive relationship with debt ratio in Malaysia due to the fact that large firms have lower bankruptcy risk and transaction cost. Logarithm of corporation's total assets is employed to proxy the firm's size effect.

3.2 Model specification

The OLS regression model will be used to test all hypotheses in the full sample period during the year 2012. As the study is intended to test whether board diversity variables have significant impact on corporate expropriation, the model is shown as below:

$$DIVS_{it} = \beta_0 + \beta WOM_{1i} + + \beta_2 FOR_i + \beta_3 TENP_i + \beta_4 FS_i + \varepsilon_i$$

Where:
DIVS dividend payout/ net sales
WOM number of women director on the board
FOR number of foreign director on the board
TENP percentage of independent directors whose tenure are greater than or equal to 8 years
FS total assets (in RM)

4. Results and discussion

4.1 Descriptive statistics

The descriptive statistics for all variables is presented in table 1. It includes observation from 289 public listed companies in Malaysia. The mean and median of absolute value of dividend to net sales ratio are 0.93 (-1.51) and 0.02 (-1.80), respectively. In term of gender, even though there are companies without woman director, there are companies which are having a maximum of 4(0.69). The sample firms also have a maximum of 7 (1.79) foreigners sit in the board of director. There are also companies without any director with tenure of at least of 8 years while there are also companies with all directors serving the board for a minimum period of 8 years. The table also shows that the average size of these sample firms is RM2, 610,436,000

Table 1. Descriptive Statistics.

Variables	Mean	Median	Maximum	Minimum
DIVS	0.930241	0.0205	35.3499	0
WOM	0.74305	0	4	0
FOR	0.434028	0	7	0
TENP	0.536497	0.5714	1	0
FS	2610436	599352	88469100	18915

4.2 Hypotheses test

The result of OLS regression of board diversity and corporate expropriation is presented in table 2. All variables except tenure of directors are transposed into logarithm which allows for the fulfillment of the OLS assumptions. The model is significant as indicated by its F-statistic. Result reported in Table 2 indicates a positive but insignificant relationship between women on board and corporate expropriation. In contrast with the hypothesis, the results is consistent with Wang and Clift (2009) who argued that such outcome is due to very few woman directors in the sample. As evidenced, our study found that on average there are about one woman director sits on the board of public listed companies in Malaysia. The findings could also be explained by the lack of talented woman in certain fields.

Furthermore, the presence of foreigner on board is positively and statistically significant (at 10% level) indicating that their presence reduces corporate expropriation of public listed companies in Malaysia. Therefore, the hypothesis that there is a positive relationship between the presence of foreign board and dividend payout is accepted. This has been proven by previous studies that presence of foreigner on board would be advantageous to the shareholders by making the board to be more independent and performing its monitoring role that are likely resulted in reducing corporate expropriation (Choi et al., 2007; Ruigrok et al., 2007; Ararat et al., 2010; Schwizer et al., 2012).

Table 2. Regression Result.

Variable	Coefficient
Constant	-6.659150
	(0.3314)
LnWOM	1.969265
	(0.1914)
LnFOR	1.685671
	(0.0559)***
TENP	-3.748295
	(0.0602)***
LnFS	0.412401
	(0.3762)
R-squared	0.331167
Adjusted R-squared	0.219695
F-statistic	2.970851
Prob(F-statistic)	0.039858**

***Significant at 5% level; ***Significant at 10% level*

On the other hand, the regression result implies that there is statistically an inverse relationship (at 10% level) between tenure and dividend payout. With negative relationship, it is evidenced that longer board tenure is associated with a lower dividend which may translated into a higher corporate expropriation. This may be an indication that board members with longer tenure and maturity have some influence that possibly leads to more expropriations due to strong relationship with the management. This makes their monitoring role to be less effective. Consistent with the previous results, long tenure directors seem to have close relationship with the management which leads to a reduction in the monitoring effect and to have an effect on decision making in the firm (Vafeas, 2003; Bebchuck & Fried, 2003). This result also consistent with the recommendation made by Malaysian Code of Corporate Governance (2012) that the tenure of an independent director should be less than nine years in order to avoid a close relationship between directors and management.

5. Conclusion

The objective of this paper is to examine the relationship between dividend payout as a proxy for corporate expropriation as the dependent variable and board diversity as the dependent variable. The relationships between the variables are analyzed based on the agency theory, where, the investigation is conducted on the setting of whether the influence of the firms' board diversity will have an effect on the firms' expropriation. The findings indicate that foreign board members as the only significant diversity measure that may play a role in dealing with corporate expropriation in Malaysia. A longer tenure do really influence decision making but surprisingly in a negative way that may worsened the degree of corporate expropriation among Malaysian firms. This study is limited to the recent data of 2012 as it deals with the manual data collection of a very large number of directors of public listed companies in Malaysia. It is suggested that future study to include a large number of observations using panel data analysis as it would lead to a more conclusive evidence on the relationship between board diversity and corporate expropriation. It is of great importance for future research to consider recommendation by Malaysian Code of Corporate Governance (2012) especially in strengthening board composition through limited tenure of independent directors.

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