

Antecedents of Ethnic Diversity: The Role of Nomination Committees

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ABSTRACT

The role of the nomination committee (NC) in the selection of members of various ethnic groups for board membership has increased significantly as a result of the global financial crisis of 2008. A company board that comprises directors who come from all the three major ethnic groups (Malay, Chinese and Indian Malaysians) increases the efficiency of the board in its monitoring and advising roles. According to the Malaysian Code of Corporate Governance (MCCG 2012), the NC shall be responsible for the appointment and recognition of candidates of diverse backgrounds into the board and committee. With that in mind, this paper examines the presence of Malay, Chinese and Indian directors in a nomination committee and its impact on the ethnic diversity of its board. This paper also examines the influence of the executive directors who are members in the nomination committee on the nomination process. For this purpose, 393 (50%) Malaysian listed companies were selected from the three year period of 2011 to 2013. Only non-financial companies were included because other companies such as finance have a different set of regulations in Malaysia. In this study, descriptive statistics, correlation and multiple regression were used for the purpose of revealing important significance of the variables used. In order to control possible endogeneity issues, the GMM estimator was also administered. The regression results of the ethnic diversity model are statistically significant, showing that, a higher proportion of Malay and Chinese directors in a nomination committee has negative relationships while a higher proportion of Indian directors in a nomination committee increases their representation on the board. However, the proportion of

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executive directors in the nomination committee was found to have a significant impact on the director nomination process of Malay, Chinese and Indian directors. In order to test the robustness of the model, several sets of measures were used. In conclusion, it is deduced that the results of this study support the social identity theory and power struggle; it shows the importance of diversity within the nominating committee of Malaysian companies. The result also reveals that unbiased and effective board mix enhances the strategic decision-making process of the board.

Keywords: Corporate Governance, Nomination Committee, Board of Directors, Malaysia, Ethnicity Diversity

JEL Classification: G34, G3

INTRODUCTION

Recent reviews of corporate governance research on corporate boards have specified that though much has been learned, it is time for reflection and the exploration of new directions in board research (Dalton, Daily, Ellstrand, & Johnson, 1998; Pettigrew & McNulty, 1995). Among the ways suggested are to embark on theoretical pluralism (Hambrick, Werder, & Zajac, 2008) and to focus on less researched areas. Among the sub-committees noted in corporate governance settings, the nomination committee (NC), as compared to audit and remuneration committee, has received the least attention from researchers. The NC plays a very critical role in the selection of members for the board. The decision of the committee will affect the board diversity and independence, which then affects the ability of the board to play its monitoring and advisory role effectively.

The NC and its role in finding and recognizing new representatives are distinctively supported by corporate governance codes. For example, the Malaysian Code of Corporate Governance (MCCG) 2012 highlights the importance of the NC by stating that it is responsible for appointing and recognizing candidates into becoming members of the board and committee. In addition, the NC is also accountable for the suggestion and procedure of the director nomination process to the board. Vafeas (1999) and Ruigrok, Peck, Tacheva, Greve, and Hu (2006) argued that efficiency to the director nomination process is principally represented by the NC. A transparent and clear selection criteria, during the selection process, facilitates the appointment of a suitable director to the board. Collectively, the board would be able to play its monitoring and advisory role through the presence of independent and competent directors. In short, the effectiveness of the board is determined by the appointments made by the NC.

It is important for the NC to have control over the selection process. Ideally, the selection process should have minimum interference from the CEO or any executive directors. A weak or non-functional NC in a company would tarnish the reputation of the NC itself and so defeats the purpose of having the NC in the first place. Hence, the composition of the NC members is important as this will affect the NC's role in selecting the ideal directors for the company. External literature on corporate governance has shown the importance of board diversity which

can improve the role of the board of directors (Marimuthu & Kolandaisamy, 2009a). Firms with directors who are women, of different races and ethnicity demonstrate a board of greater cultural composition (Marimuthu & Kolandaisamy, 2009a) and the board, in turn, will perform its responsibilities more effectively. According to Yusoff (2010), diversity at top management level improves the overall performance of the firm. Specifically, it improves decision-making processes, policies and procedures, and business networking. Researchers (Marimuthu & Kolandaisamy, 2009b; Shukeri, Shin, & Shaari, 2012) found that ethnicity and firm performance have a positive and significant relationship, in the Malaysian context.

Irrespective of culture and race, every ethnic group has its own distinctive identities, for example, different religious principles, traditions, language, values and various other phenomena (Hamzah-Sendut, Madsen, & Thong, 1989; Jamil & Razak, 2010). With this distinctive differences, socialization is also distinctive as these integrations can affect and influence business tradition, firms and other services (Che-Ahmad & Houghton, 2001; Haniffa, Yatim, Kent, & Clarkson, 2006; Hofstede, 1991). Hence, different ethnic groups have a relation to diversity on corporate boards and an ethnically diverse board can develop a positive image for the firm (Marimuthu & Kolandaisamy, 2009b).

This paper focuses on the NC's composition in selecting an ethnically diversified board of directors in Malaysian firms. The paper examines the three major ethnic groups of Malaysia (i.e. Malay, Chinese and Indian) which serves as a perfect setting to examine this relationship as it is multicultural and recently, had just adopted the Malaysian Code of Corporate Governance about the importance of the NC. This paper has two main objectives. First, it examines the effect of Malay, Chinese and Indian director's proportion in the NC with ethnic diversity in the board of Malaysia's listed firms. The balanced mix of ethnic groups in the NC is significant in bringing out the benefits of having a diverse board in the Malaysian corporate sector. Second, the paper examines if the Malay, Chinese and Indian director's contribution can be enhanced when the nomination process is not influenced by the executive directors who have current distribution of powers (Finkelstein & Hambrick, 1996).

This paper contributes to the existing research in three ways. First, it sheds light on the contribution of Malay, Chinese and Indian directors on the board of Malaysian firms by examining the balanced mix of Malay, Chinese and Indian directors on the NC. The findings of this paper show that the higher proportion of ethnic groups in the NC seems to facilitate board diversity. Second, the empirically validated findings showed that the higher proportion of executive directors in the NC can counteract the nomination process of directors. Third, the findings of this paper contribute to pluralistic corporate governance research by drawing the concept of social identity and power struggle to create the theoretical basis for this paper which displays the influence of the NCs on ethnic diversity, and consequently, for board composition.

The remaining paper is organized as follows: Section 2 presents the literature review and hypothesis development. Section 3 discusses the samples, model specification and measurement of variables. Section 4 presents the results and discussion and Section 5 concludes the paper.

LITERATURE AND HYPOTHESIS DEVELOPMENT

Ethnic Groups in NC and Ethnic Diversity

Social identity is best defined as the understanding of one individual who belongs to a certain social group together with one's emotional and value significance as a group member (Tajfel, 1978). Conversely, social identity is derived from the individual categorization, the discrepancy and prestige of the group, the prominence of outgroups, and the elements that are corresponding with the formation of the group. Thus, the social identification of an individual may be compatible with the shared sense of group belonging which supports the social groups that symbolize their identity and nurture their perceptions (Ashforth & Mael, 1989). For instance, racial identity will provoke racism with other racial groups. Individuals are motivated to favour their own racial group by sustaining the positive group identity over other racial groups. The in-group favourable may resist certain favourable action policies when these policies are designed to benefit the other racial group members as well. This theory also states that people categorize themselves into meaningful social categories which influence their communication with others from their own identity group or other groups (Tajfel, 1978, 1982; Tajfel & Turner, 1986; Turner, Hogg, Oakes, Reicher, & Wetherell, 1987).

Boards with ethnic diversity enhance and create the value of the firms. Under those circumstances, people of diverse race on the board tend to have different and unique ideas, experiences and power of thinking and this serves as the basis for better outcomes during the decision making process and policy making process. In Malaysia, there are three major ethnic groups in proportional percentages: Malays make up 67.4%, Chinese make up 24.6% and Indians make up 7.3% of the total population of the country (Malaysia, 2010). Due to its diverse ethnic background, Malaysia is influenced by different religious principles, traditions, languages, and values. If Malaysian firms were to comprise of boards of diverse ethnicity, the positive image of the firms will be increased (Marimuthu & Kolandaisamy, 2009b). However, the cultural values of each ethnic group varies from one to another (Hofstede, 1991) for example, high level of ethnic Malays tend to avoid uncertainties because they are uncomfortable with things that they do not know, hence, they avoid ambiguities (Abdullah 1992). In contrast, very low level of ethnic Chinese avoid uncertainties as it has been proven that they are willing to accept new challenges and take risks (Abdullah 1992). The Chinese ethnic group follow the individualism, which states that each individual is acting on his or her own, making their own choices, based on the expected benefits among the ethnic groups (Tan, 1984). In consistent, of Indian ethnic group are low in uncertainty avoidance (Abdullah 1992). Based on the above differences, Malay directors are likely to have a negative association on the level of ethnic diversity on the board. Thus, a high variation of ethnicity in the NC will lead to a higher chance of a board having a diverse ethnicity. The hypotheses formulated are listed below:

Hypothesis 1. *NC containing Malay directors will be negatively associated on the level of ethnic diversity on the board.*

Hypothesis 2. *NC containing Chinese directors will be positively associated on the level of ethnic diversity on the board.*

Hypothesis 3. *NC containing Indian directors will be positively associated on the level of ethnic diversity on the board.*

Executive Directors in NC and Ethnic Diversity

There is a current preference for an increase in monitoring and control over management and this has instigated the need to have the appointment of competent directors who can exercise their duties with diligence. Several empirical studies have shown that an independent NC that comprises independent members is less likely to be influenced by the CEO or other executive directors in the director appointment process. This occurrence will increase the recruitment of directors with reputations for being active in exercising their control over the executive directors. Alternatively, a non-functioning or weak NC is likely to be influenced by the CEO or other executive directors (Zajac & Westphal, 1996).

Taking that into consideration, this paper takes into account the balance of power between the CEO and executive directors in influencing the nomination of subsequent director appointments. This dimension is particularly important because the NC is the main player in the directors' selection process (Zajac & Westphal, 1996).

According to the power struggle theory, the primary role of the board should be the monitoring of the company's management. The concern of a CEO is to have as many executive directors as he can find to be able to cooperate closely with him/her on matters that are close to his interest and less likely to be questioned or disputed by the directors, on the board. Nevertheless, the NC also has the opportunity to increase the diversity of board members and to decrease the impact or influence of the management (Firstenberg & Malkiel, 1994; Jensen, 1993; Westphal, 1998; Westphal & Zajac, 1995). Most importantly, the NC must be influential enough to introduce its own independent suggestions and not be influenced by the CEO or the executive directors. If the CEO is a member of the NC or if the NC is dominated by the executive directors, the NC and its director appointment process will be hindered (Shivdasani & Yermack, 1999). Hence, hypotheses for this study were developed, where the relationship between each ethnicity in the NC and ethnic diversity in the board is moderated by the proportion of the executive directors. The hypotheses are listed below:

Hypothesis 4. *Malay directors on the NC and the ethnic diversity on board is positively moderated by the proportion of ED in NC committee.*

Hypothesis 5. *Chinese directors on the NC and the ethnic diversity on board is positively moderated by the proportion of ED in NC committee.*

Hypothesis 6. *Indian directors on the NC and the ethnic diversity on board is positively moderated by the proportion of ED in NC committee.*

METHODOLOGY

Sample Selection

The sample for this research comprises 50% of the non-financial companies that were listed on the Bursa Malaysia that were from ten sectors - Trading/Services, Consumer products, Industrial Products, Plantation, property, Infrastructure Projects, construction, Technology, Hotel, and Mining. Data were collected from the three year period encompassing 2011 to 2013 using stratified sampling. The financial sectors were excluded from this study because financial companies in Malaysia are subjected to different sets of regulations. Newly established companies of the same period and insolvent companies or companies that underwent restructuring were also excluded to minimise missing data, leaving the final sample of 393 companies and 1179 firm-year observations. Financial data were obtained from DataStream database and the corporate governance data were manually collected from annual reports. A regression was run with and without the general method of moment (GMM) model to address endogeneity issues.

Model Specification

It is important to note that when examining ethnic diversity, the main variables to be considered are the proportion of Malay, Chinese and Indian directors and the executive directors in the NC. The control variables observed in this research include firm size, firm age, firm performance and board size. Figure 1 summarizes the main factors affecting ethnic diversity and the control variables employed.

Eq. (1) shows the basic model used in the study

$$EthnD_{it} = \beta_1 MD_{it} + \beta_2 ChiD_{it} + \beta_3 InD_{it} + \beta_4 ROE_{it} + \beta_5 Frsize_{it} + \beta_6 Frage_{it} + \beta_7 BS_{it} + \epsilon_{it} \quad (1)$$

Where: i = number of companies and across, t = 2011 to 2013 (3 years), $EthnD_{it}$ = Ethnic diversity index using BLAU of i th companies at time t , MD_{it} = proportion of Malay directors on nc of i th companies at time t , $ChiD_{it}$ = proportion of Chinese directors on nc of i th companies at time t , InD_{it} = proportion of Indian directors on nc of i th companies at time t . ROE_{it} = Return on Equity of i th companies at time t , $FrSize_{it}$ = natural logarithm of total sales of i th companies at time t , $FrAge_{it}$ = number of years since firm establishment of i th companies at time t , BS_{it} = the total number of directors of i th companies at time t , ϵ_{it} = error terms of i th companies at time t .

Interaction terms were added to take into effect the influence of the executive directors (ED) on the relationship between the proportion of each ethnic director in the NC and ethnic diversity in the board. The extension of the basic model is depicted in Eq. (2).

$$EthnD_{it} = \beta_1 MD_{it} + \beta_2 ChiD_{it} + \beta_3 InD_{it} + \beta_4 ROE_{it} + \beta_5 Frsize_{it} + \beta_6 Frage_{it} + \beta_7 BS_{it} + \beta_8 EDXMD_{it} + \beta_9 EDXChiD_{it} + \beta_{10} EDXInD_{it} + \epsilon_{it} \quad (2)$$

Measurement of Variables

The dependent variable of the research is Ethnic diversity (ETHND). The Blau index was used to measure diversity. The Blau index is considered as one of the traditional measures which is principally focus on single characteristics (e.g., ethnicity). The Blau index of heterogeneity (BLAU) was also measured $1 - \sum_{i=1}^n P_i^2$ where, P_i stands for the proportion of each category and n stands for the total number of board members. Values of the BLAU for ethnic diversity ranged from 0 to a maximum 0.333 which specifies that the board contains an equal number of Malay, Chinese and Indian directors (Blau, 1977).

The independent variables employed in this study comprise Malaysia's three major ethnic groups: proportion of Malay (MD), proportion of Chinese (CHID) and proportion of Indian directors (IND) in the NC. The proportion of executive directors (ED) in the NC constitutes as the moderating variable. The effect of board size, firm size, firm age and firm performance was controlled. Board Size (BS) is the total number of directors serving on the board that is prone to impact the board composition. Firm size is equivalent to the total sales of the firm (Frsize). Firm performance is measured by the return of equity (ROE) that is accounting based measure which is also linked to board proceedings. This variable is a crucial factor because the profitability affects the way firms manage their daily business activities. Firm performance has a positive relationship with diversity at the board level (Erhardt, Werbel, & Shrader, 2003; Lückerrath-Rovers, 2013; Triana, Miller, & Trzebiatowski, 2013). Firm Age (Frage) is measured in economic term via the number of years since the firm was established. Long established corporations are more probable to encirclement-intensely entrenched procedures which discourage them from employing directors from diverse backgrounds (Minichilli, Corbetta, & MacMillan, 2010).

RESULTS AND DISCUSSION

The summary of the descriptive statistics of the variables for the year 2011 to 2013 is presented in Table 1. The average ethnic diversity index value is 0.3332 i.e. 33%, which suggests that the boards are reasonably diverse in terms of ethnicity.

Table 1 also shows the mean of the proportion of Malay, Chinese and Indian directors to be 0.401, 0.545, and 0.0297 respectively. The mean value of the presence of Malay ED in the NC is 0.0508 as compared to Chinese and Indian ED with a mean value of 0.0656 and 0.00456 respectively. Based on the result, it can be said that the Chinese have the highest presence in the NC as executive directors followed by Malay directors and then Indian directors.

Table 1, also reports on the descriptive statistics of the control variable comprising of firm performance, firm age, firm size and board size. The results show that board size ranges from four directors to a maximum of fourteen directors. The findings also show a fluctuating pattern of the ROE over the three year period where 6.066% was recorded in 2011 and 5.050 and 5.914 for 2012 and 2013 respectively. In terms of firm age, it was found that the minimum firm age is 1.1 years and the maximum firm age is 5.22 years. The minimum total sales of the sampled firms is 4.5 while the maximum total sales of the sampled firms is 17.68. In conclusion, most

data showed little variation with the standard deviation of 1.920131 for board size. In addition, the kurtosis value of all the variables are positive. In contrast, the proportion of Chinese in the NC and Firm Age has a negative skewness of - 0.192471 and - 0.068428 respectively.

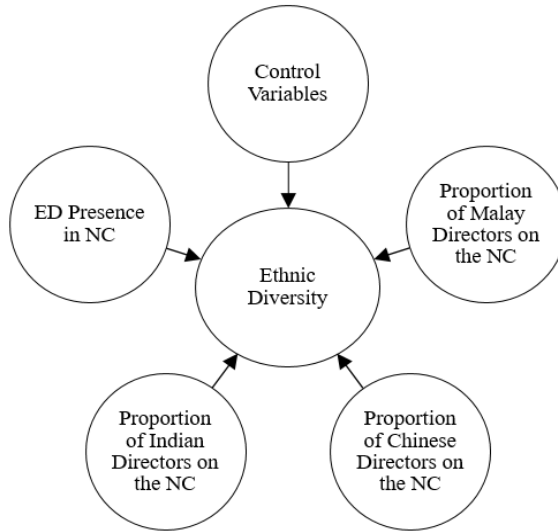


Figure 1. Factors affecting Ethnic Diversity

Figure 1 summarizes the main factors affecting ethnic diversity and also the control variables.

Table 1. Descriptive Statistics of Ethnic Diversity

Variable	Year	N	Mean	Median	Sd.	Min.	Max.
EthnD	2011	393	0.333263	0.345679	0.020928	0.000000	0.938272
	2012	393	0.333263	0.345679	0.204795	0.000000	0.250000
	2013	393	0.333263	0.345679	0.020928	0.000000	0.250000
	Pooled	1179	0.333263	0.345679	0.019468	0.000000	0.753000
MD	2011	393	0.397498	0.333333	0.325960	0.000000	1.000000
	2012	393	0.413147	0.333333	0.327850	0.000000	1.000000
	2013	393	0.392706	0.333333	0.324029	0.000000	1.000000
	Pooled	1179	0.401117	0.333333	0.325790	0.000000	1.000000
ChiD	2011	393	0.549406	0.666667	0.342263	0.000000	1.000000
	2012	393	0.533969	0.666667	0.336716	0.000000	1.000000
	2013	393	0.551696	0.666667	0.337321	0.000000	1.000000
	Pooled	1179	0.545024	0.666667	0.338580	0.000000	1.000000
InD	2011	393	0.030619	0.000000	0.109813	0.000000	0.666667
	2012	393	0.028075	0.000000	0.103882	0.000000	0.666667
	2013	393	0.030280	0.000000	0.102895	0.000000	0.666667
	Pooled	1179	0.029658	0.000000	0.105490	0.000000	0.666667

Table 1 : (Cont.)

ED X MD	2011	393	0.048984	0.000000	0.107104	0.000000	0.750000
	2012	393	0.053721	0.000000	0.113255	0.000000	0.750000
	2013	393	0.049723	0.000000	0.108541	0.000000	0.750000
	Pooled	1179	0.050809	0.000000	0.109591	0.000000	0.750000
ED X ChiD	2011	393	0.066742	0.000000	0.126568	0.000000	1.000000
	2012	393	0.066044	0.000000	0.125943	0.000000	1.000000
	2013	393	0.064118	0.000000	0.113664	0.000000	0.666667
	Pooled	1179	0.065635	0.000000	0.122105	0.000000	1.000000
ED X InD	2011	393	0.004356	0.000000	0.025012	0.000000	0.222222
	2012	393	0.003791	0.000000	0.022455	0.000000	0.222222
	2013	393	0.004056	0.000000	0.023084	0.000000	0.222222
	Pooled	1179	0.004056	0.000000	0.023084	0.000000	0.222222
ROE	2011	393	1.598972	1.791759	1.241139	0.000000	6.066108
	2012	393	1.656684	1.791759	1.204804	0.000000	5.049856
	2013	393	1.552673	1.791759	1.202270	0.000000	5.913503
	Pooled	1179	1.602777	1.791759	1.215913	0.000000	6.066108
FrAge	2011	393	3.297430	3.330000	0.660424	1.390000	5.210000
	2012	393	3.249924	3.300000	0.693264	1.100000	5.210000
	2013	393	3.341425	3.370000	0.631956	1.610000	5.220000
	Pooled	1179	3.296260	3.330000	0.662848	1.100000	5.220000
FrSize	2011	393	12.17926	12.11000	1.820964	5.800000	17.68000
	2012	393	12.11557	12.06000	1.842526	5.090000	17.55000
	2013	393	12.17214	12.12000	1.856506	4.510000	17.66000
	Pooled	1179	12.15566	12.09000	1.838715	4.510000	17.68000
BS	2011	393	7.269720	7.000000	1.933466	4.000000	14.00000
	2012	393	7.218830	7.000000	1.889269	4.000000	14.00000
	2013	393	7.272265	7.000000	1.941667	4.000000	14.00000
	Pooled	1179	7.253605	7.000000	1.920131	4.000000	14.00000

ETHD ethnicity diversity,
ChiD proportion of Chinese directors on nc,
MD proportion of Malay directors on nc,
InD proportion of Indian directors on nc,
ROE return on equity,
FrAge Firm Age,
FrSize firm size,
BS board size.

Table 2 shows the results of ethnic diversity, according to industry sectors, as classified by the Bursa Malaysia. The Malay and Chinese groups filled most of the boards and the NC seats. Only 8% of Indian directors sit on boards and 5% in the NCs. The low rate of Indian

participants as directors is consistent with previous studies (Marimuthu & Kolandaisamy, 2009b; Shukeri *et al.*, 2012). In terms of ethnic diversity in the NC and boards, the trading and services sector, the industrial product sector and consumer products sectors appear to be more balanced in appointing directors from all three major ethnic groups when compared to the other firms in other sectors.

Table 3 shows the correlation matrix of all the variables used in the analysis. There is no significant correlation between the variables therefore, the model does not suffer from any multicollinearity issue.

Table 2. Sectors and Ethnic Diversity

Sector	N	Pro. BS	MD Board	ChiD Board	InD- Board	Pro. NC	MD NC	ChinD NC	InD NC
Industrial Product	124	0.07	54 (45%)	62 (50%)	8 (5%)	0.03	53 (43%)	67 (54%)	4 (3%)
Consumer Product	63	0.07	26 (41%)	32 (51%)	5 (8%)	0.03	25 (40%)	34 (53%)	4 (7%)
Trading & Services	84	0.07	36 (43%)	38 (45%)	10 (12%)	0.03	39 (47%)	38 (45%)	7 (8%)
Infrastructure Projects	6	0.08	3 (50%)	3 (50%)	0 (0%)	0.03	3 (46%)	2 (36%)	1 (18%)
Plantation	27	0.07	12 (46%)	13 (48%)	2 (6%)	0.03	11 (40%)	15 (55%)	1 (5%)
Properties	27	0.07	12 (47%)	14 (51%)	1 (2%)	0.02	15 (55%)	12 (45%)	0 (0%)
Hotel/Mining	5	0.06	2 (40%)	3 (60%)	0 (0%)	0.03	2 (43%)	3 (57%)	0 (0%)
Construction	18	0.07	9 (47%)	8 (44%)	1 (8%)	0.03	11 (59%)	7 (41%)	0 (0%)
Technology	39	0.06	15 (39%)	21 (53%)	3 (8%)	0.02	14 (35%)	23 (58%)	2 (7%)
Total	393	0.07	169 (43%)	194 (49%)	30 (8%)	0.03	173 (44%)	201 (51%)	19 (5%)

N number of Malaysian companies,

Pro. BS Proportion of board size,

MD Board proportion of Malay directors on board,

ChiD Board proportion of Chinese directors on board,

InD Board proportion of Indian directors on board,

Pro. NC Proportion of nomination committee size,

MD NC proportion of Malay directors on NC,

ChiD NC proportion of Chinese directors on NC,

InD NC proportion of Indian directors on NC.

Table 3. Correlation Matrix on NC & Ethnicity Diversity

Variable	ETHND	CHIND	MD	IND	ROE	FA	SIZE	BS	ED X MD	ED X CHIND	ED X IND
ETHND	1	-.310**	-.352**	.257**	.092**	.106**	.207**	.105**	0.032	-.130**	.179**
CHIND	-.310**	1	.799**	.109**	-.066*	0.023	-0.02	0.003	.156**	-0.045	0.04
MD	-.352**	.799**	1	-.091**	-.097**	-0.003	-0.034	-0.023	.247**	-.084**	-.060*
IND	.257**	.109**	-.091**	1	.058*	0.022	0.013	0.05	-0.016	-.063*	.600**
ROE	.092**	-.066*	-.097**	.058*	1	.095**	.381**	.207**	-0.054	-.098**	-0.011
FA	.106**	0.023	-0.003	0.022	.095**	1	.342**	.126**	-0.016	-.081**	-0.041
SIZE	.207**	-0.02	-0.034	0.013	.381**	.342**	1	.383**	0.007	-0.043	-0.023
BS	.105**	0.003	-0.023	0.05	.207**	.126**	.383**	1	0.01	-0.055	-0.01

ETHD ethnicity diversity,

ChiD proportion of Chinese directors in NC,

MD proportion of Malay directors in NC,

InD proportion of Indian directors in NC,

ROE return on equity,

FrAge Firm Age,

FrSize firm size,

BS board size,

***significant at 1% level

**significant at 5% level

*significant at 10% level

Table 4. Multiple Regression Results of NC & Ethnicity Diversity Model

Variable	Model 1			Model 2		
	Coef	t	sig	Coef	t	sig
(Constant)	0.5582	12.547	0.000***	0.5497	12.470	0.000***
BS	-0.0040	-2.3127	0.020**	-0.0037	-2.201	0.027**
FrSize	0.0032	1.8130	0.070**	0.0032	1.830	0.0674*
FrAge	0.0003	2.6793	0.0075**	0.0003	2.431	0.0152**
ROE	8.35E	0.7745	0.4388	0.0001	1.098	0.2723
MD	-0.1581	-4.3453	0.000***	-0.1489	-4.121	0.000***
ChiD	-0.2677	-7.3729	0.000***	-0.2604	-7.225	0.000***
InD	0.2054	4.4665	0.000***	0.2055	4.483	0.000***
ED X MD	-	-	-	0.0360	2.789	0.005**
ED X ChiD	-	-	-	0.0501	3.739	0.0002**
ED X InD	-	-	-	0.0163	3.008	0.002**
Model fits:						
R-squared			0.255			0.273
F-statistic			57.52			44.05
Prob.(F-statistic)			0.000***			0.000***
Durbin-Watson stat			0.906			0.909
Variance inflated factor (VIF)			1.017			1.120

ETHD ethnicity diversity,

ChiD proportion of Chinese directors in NC,

MD proportion of Malay directors in NC,

InD proportion of Indian directors in NC,

ROE return on equity,

FrAge Firm Age,

FrSize firm size,

BS board size,

***significant at 1% level

**significant at 5% level

*significant at 10% level

Tables 4 and 5 show the results of regression and GMM estimations. Tables 4 and 5 indicate the effect of major ethnic groups representation in the NC on ethnic diversity in boards.

The multiple and GMM regression results shown in Tables 4 and 5 indicate that the proportion of Malay MD and Chinese ChiD have a significant negative effect on ethnic diversity, while Indian InD directors have a significant positive effect on ethnic diversity in boards. The results are generally consistent with the findings of US firms by Carter *et al.* (2010) and Erhardt *et al.* (2003). Tables 4 and 5 also show the results of the interaction terms with three major ethnic groups based on the proportion of executive directors with Malay EDXMD, with Chinese EDXChiD, and with Indian EDXInD directors. The results of the interaction terms indicate a positive relationship with ethnic diversity across both estimations.

Table 5. GMM Results of NC & Ethnic Diversity Model

Variable	Model 2		
	Coef	t	Sig
(Constant)	0.4210	5.477	0.000***
ETHD (-1)	0.4625	15.00	0.000***
BS	-0.0045	-2.152	0.031**
FrSize	1.78E-	0.192	0.847
FrAge	0.0001	0.755	0.450
ROE	-0.0393	-1.118	0.263
MD	-0.0944	-2.313	0.20**
ChiD	-0.1735	-4.369	0.000***
InD	0.1511	2.991	0.002**
ED X MD	0.0238	1.792	0.0073*
ED X ChiD	0.0316	2.353	0.018**
ED X InD	0.0104	1.960	0.050*
Model fits:			
R-squared			0.310
Durbin Watson stat			1.801
J-statistic			2.87
Prob.(J-statistic)			0.57

ETHD ethnicity diversity,
ChiD proportion of Chinese directors in NC,
MD proportion of Malay directors in NC,
InD proportion of Indian directors in NC,
ROE return on equity,
FrAge Firm Age,
FrSize firm size,
BS board size,

***significant at 1% level

**significant at 5% level

*significant at 10% level.

The result of the moderating effect of executive director representation in the NC is crucial because it indicates that an increase in executive director representation will have greater influence on the selection process of the three major ethnic groups in the NC and board. The

finding is in line with the evidence documented by Shivdasani and Yermack (1999) who found that executive directors increase their power on the selection process if the NC is dominated by executive directors. Tables 4 and 5 also include the results of four control variables comprising firm performance, firm age, firm size, and board size.

Based on the results seen in Tables 4 and 5, it can be said that all the hypotheses are supported whereby the results are statistically significant at the 1% to 5 % level respectively except for ROE. Table 5 further reports the Hansen J statistics (2.87) for the ethnic diversity model which means that the null hypothesis is rejected, thus indicating that there is no issue of endogeneity. Finally, the Durbin Watson statistics value is 1.801 which indicates that there is no autocorrelation in the sample.

Table 6. Summary Result of Ethnic Diversity Model

Ethnicity Diversity Model						
No	Variable	Hypothesis	Result	Predict sign	Actual sign	Decision
1	MD	2a	1% significance	-	-	Support
2	ChiD	2b	1% significance	+	-	Not support
3	InD	2c	1% significance	+	+	Support
4	ED X MD	2d	1% significance	+	+	Support
5	ED X ChiD	2e	1% significance	+	+	Support
6	ED X InD	2f	1% significance	+	+	Support

ETHD ethnic diversity,

ChiD proportion of Chinese directors in NC,

MD proportion of Malay directors in NC,

InD proportion of Indian directors in NC,

ROE return on equity,

FrAge Firm Age,

FrSize firm size,

BS board size,

***significant at 1% level

**significant at 5% level

*significant at 10% level

Table 6 summarises the results of the ethnic diversity models. The results were based on the hypotheses (H1 – H6). In this regard, Hypothesis 1 is accepted at 1 % significance level, which means that the lower proportion of Malay directors in the NC will lead to higher level of ethnic diversity in the board. Nonetheless, the cultural values derived from each ethnic group could vary from one to the other. It appears that a high level of ethnic Malays on company boards can deter uncertainty because Malays are generally, uncomfortable with things that they do not know and they also avoid ambiguity (Abdullah, 1992). In this regard, Malay directors are likely to be negatively associated with Ethnic diversity on the board, in contrast to Indian directors. Nevertheless, the model supports the arguments that the nomination process of candidate directors cannot be cultural free.

Hypothesis 2 is not significant at 1 % level, but it shows the opposite direction which implies that a low proportion of Chinese directors in the NC will lead to high level ethnic diversity in boards. The Chinese ethnic group follow the individualism, which states that each individual is acting on his or her own, making their own choices, based on the expected benefits among the ethnic groups (Tan, 1984). An alternative interpretation is that the firms

dominated by Malay directors reflects a response to 'traditional hostility towards the Chinese who, with their entrepreneurial skills, have tended to exert economic influence out of proportion to their numbers' (Maidment and Mackerras, 1998, p. 6). Therefore, the presence of Chinese directors on the NC is likely to have a negatively associated with Ethnic diversity on the board, in consistent to Malay.

Hypothesis 3 is accepted at 1 % significance level which means that a high proportion of Indian directors in the NC will lead to high level ethnic diversity in boards. The rest of the Hypotheses (4- 6) are statistically significant at 1% level, confirming the influence of the executive directors in the nomination process of Malay, Chinese and Indian directors. It further indicates that a high proportion of executive directors in the NC will lead to greater influence of the management in the nomination process. Gray (1988) noted that the Indian ethnic group was categorized as being less professional in the accounting field. They tend to have a more uniform, high conservative and high secrecy value. It was noted that the Indian ethnic group was high in uncertainty avoidance (Abdullah, 1992). Therefore, Indian directors are likely to have a positively associated relation on the level of Ethnic diversity on the boards, in contrast to Malay.

CONCLUSION

Based on the outcome of the paper, it is concluded that the composition of the NC has a direct effect on board diversity. The existing corporate governance code had merely focused on the board as a whole, and very little concerns were devoted to the composition of NC members. These results clearly support the fact that the executive directors can cast their influence on board diversity. Thus, the findings of this study is important to regulators such that the NC itself should be, to a certain extent, be regulated. Ethnic diversity has become an important agenda in a multiethnic country like Malaysia. Since the NC's role is on identifying and selecting future directors of the company, each member of the NC plays a vital role in determining board mix.

Based on the results of this paper, it can be concluded that the structural characteristics of the NCs have a significant influence on the outcome of board compositions. The proposition of these results are well-timed in the stir of calls for boards to appoint a balanced mix of ethnic groups from diversified backgrounds. It is found that board ethnic diversity is negatively influenced by the increasing existence of Malay and Chinese directors in the NC. These results provide an interesting picture which relates to ethnic participation at top management level. It should be noted that only large companies seemed serious about promoting ethnic diversity at top level management. The most important thing that can be drawn from this paper is that ethnic participation really effects and matters in companies. Based on the empirical findings, some recommendations can be made to suggest for ethnic diversity among board level in listed companies of Malaysia. A mandatory proportion of ethnic diversity at board level should be established. The government and other regulatory bodies should ensure and make this a necessary requirement for companies.

The results pinpoint the essential fundamental basics of director selection and selection procedures in board backgrounds from an Asian financial system that could be significant to

in rest of the backgrounds. It is also suggested that longitudinal studies encompassing more than 10 year periods be conducted in order to get the trend and to acquire a more generalized set of results. Future studies should also consider other corporate governance mechanisms such as ownership structure in order to examine the influence of director's holdings on the nomination process. It is further recommended that future studies look into this issue in order to provide diverse frameworks to provide for a deeper view on the function and power of the NCs in creating crucial board decisions concerning board director selections.

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