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IMPACT OF BOARD DIVERSITY TO **FINANCIAL PERFORMANCE** IN INDONESIAN **LISTED** 11

MANUFACTURING COMPANIES Christoforus Hervindra B. and Josua Tarigan International Business Accounting

Petra Christian University Email: josuat **@petra.ac.id ABSTRACT** 116

The

study is conducted to examine the influence of board diversity to 109

financial performance of listed companies in Indonesia. This study extends the empirical evidence on the 50

diversity on board and its relation to the financial performance in Indonesian context which still rarely discussed previously. Board diversity, as the independent variable uses three indicator variable of gender diversity, nationality diversity, and education diversity. Financial performance will be measured

using return on asset (ROA) and Tobin's Q. 22

This research is focused on the manufacturing companies listed in Indonesian Stock Exchange 54

and published their annual report in the year 2011-2015 (5 years). The data observation in this research including 525 data from 105 listed manufacturing companies. Statistical analysis of ordinary least square (OLS) will be conducted using IBM SPSS Statistics 19. The result of the study

reveals that the women on board have a negative 1

effect to the

return on asset and Tobin's Q. Foreigners on board have a positive 74

effect to the

financial performance measured with return on asset and Tobin's Q. 25

While education on board have no significant effect to return on asset, and have negative effect to

Tobin's Q. Keywords: Corporate governance, board of directors, 82

board diversity, financial performance, Indonesia, manufacturing. ABSTRAK Penelitian ini dilakukan untuk mempelajari pengaruh dari persebaran dewan terhadap kinerja keuangan perusahaan terbuka di Indonesia. Riset ini akan memperluas bukti empiris persebaran pada dewan dan pengaruhnya terhadap kinerja keuangan dalam konteks negara Indonesia yang jarang didiskusikan sebelumnya. Persebaran dewan, sebagai variabel independen menggunakan tiga variabel indikator yang meliputi persebaran jenis kelamin, persebaran kewarganegaraan, dan persebaran pendidikan. Kinerja keuangan akan diukur menggunakan return on asset (ROA) dan Tobin's Q. Penelitian ini berfokus pada perusahaan manufaktur terbuka di Indonesia yang menerbitkan laporan keuangan pada tahun 2011-2015 (5 tahun). Analisa statistika menggunakan ordinary least square (OLS) akan dilakukan dengan memakai IBM SPSS Statistics 19. Hasil dari studi ini menunjukkan bahwa wanita pada dewan memiliki pengaruh negative terhadap return on asset dan Tobin's Q. Orang berkewarganegaraan asing pada dewan memiliki pengaruh positif terhadap kinerja keuangan yang diukur menggunakan return on asset dan Tobin's Q. Sedangkan pendidikan pada dewan tidak memiliki pengaruh signifikan terhadap return on asset, serta memiliki pengaruh buruk terhadap Tobin's Q. Kata kunci: Corporate Governance, dewan komisaris, persebaran dewan, kinerja keuangan, Indonesia, manufaktur. INTRODUCTION Conflict of interest may emerge when separation of ownership and management exist in a company. The managers will have the interest of maximising their own welfare instead of maximising the

shareholder's wealth (Jensen& Meckeling, 1976). This condition is often called as the agency 62

conflicts (Hart, 1993). A

corporate governance is a concept that is needed to reduce the agency 70

conflicts (Dimitropoulos, 2014). An optimal board composition is required as a proper governance of companies.

The composition of the board will affect the effectiveness of the board, how the 49

board perform their roles, hence will affect the financial performance of the company (Gordini & Rancati, 2017). There are various definition of board composition by the researchers, such as

percentage of insider on board (Agrawal & Knoeber, 1996), directors and managers term of service (Hermalin & Weisbach, 1991), 9

board size (Kini, Kracaw, & Mian, 1995), and remuneration scheme used (Rose, 2007). In recent times, many researchers

such as Campbell and Minguez-Vera (2008), Masulis et al. 2

(2012), Mensi Klarbach (2014), Ntim (2015), Rose (2007), and Wynarczyk (2007), draw the interest to the board diversity topic as it will affect the effectiveness of the firm and ultimately the firm financial performance. Gender, cultural and racial

composition of the board of directors is among the significant 78

governance issues that current modern corporation managers, directors and shareholders are facing. It also draws the attention from popular press, proposal from advocacy group, and major institutional investors (Carter, et al., 2003). Moreover, following the major corporate scandals around the globe such as Enron, WorldCom, HIH Insurance, and Parmalat, many practitioners also encourage the diversity on board (Ujinwae et al., 2012). This issue also supported by

Securities and Exchange Commission (SEC) approve a rule that requires company to disclose 23

the diversity information on board in December 2009 (Wahid, 2012). In conclusion, the board diversity is become a significant issue among global corporations. There are several prior studies about board diversity and financial performance. Gordini & Rancati (2017) study the Italian corporation about

board diversity measured with the percentage of women on board 66

which has a positive relation to the financial performance measured with Tobin’s Q. 26

Positive relation

of board diversity and financial performance also found in the research 111

by several other researchers such as Kilic & Kuzey (2016) using samples from Turkish corporation, Mahadeo et al. (2012) with Mauritius corporation as the sample, and Campbell & Minguez-Vera (2008) using Spanish firms data. However negative link (Ahern & Dittmar, 2012) is found in the

relationship between board diversity and financial performance. Moreover, most of the above researches defines the diversity on board 21

only related to the gender mixture that presence on the board.

On the other hand, the study conducted by Fidanoski, et al. (2014) using 33

a different way in defining the

board diversity in terms of gender, education and nationality 33

differences on board. Research conducted Fidanoski et al. (2014) aimed

to find the effect of board diversity to the company performance 81

which depicted in form of

Tobin's Q and return on asset (ROA). The result of the 6

research conclude that companies with more educated member and woman on board tend to be more profitable and overvalued on the market, while the companies with more foreigners are subject of undervaluation. This study investigate the

influence of board member diversity of the Indonesian listed firms on financial performance, which measured by Tobin's Q, as the market-based performance measure, and return on asset (ROA), as the accounting-based measure. 1

Furthermore,

gender, nationality, and education are used as the proxies for diversity 1

on board. This research aims to conduct study in listed manufacturing companies specifically in Indonesia. Manufacturing companies are companies which engage in

production of merchandise for use or sale using labour and machines, tools, chemical and biological processing, or formulation (Kapoor, 2017). Listed manufacturing 24

companies in Indonesia

divided into three sectors, which are basic and chemical sector, miscellaneous industry, and 39

consumer goods industry (IDX, 2017). This makes the market share in the industry is more evenly spread, better competition and future prospects. Aside from that, manufacturing industry is the largest contributor for 2016 economy with 20,51%, followed with two other large industries, agriculture as well as retail and wholesale industry with 13.45% and 13.19% respectively (BPS, 2016). Thus this study aims to find the

empirical evidence on the impact of board diversity towards the company performance in Indonesia. The 48

journals and papers that has already been made by some authors are mostly talking about their country's scope, and rarely are talking about the relationship and

impact of board diversity towards the company performance in Indonesia. One of the 30

research talking about Indonesian scope is written by Darmadi (2010) using

gender, nationality, and age as the proxy of diversity. 4

The difference from Darmadi (2010) research with this paper is the different proxy of diversity used. This paper is using gender, nationality and education as the proxy of diversity. The control variable used in this chapter also different with those used in Darmadi (2010) research. Hence, it differs with the previous studies and could fill the research gap. Through this research, author would like to measure the correlation of board 73

diversity towards the company financial performance in listed company in Indonesia particularly in manufacturing sector. Whereas the earlier paper majorly talked about all sectors of the stock exchange, which created another research gap. The research will be done through the process of collecting secondary data, testing the hypothesis, as well as analyzing regression

to identify the correlation of each variable. The board of directors 14

have an important role to make sure a good corporate governance. Supposedly, this paper would like to help the company's directors, to examine whether or not the diversity on board is needed. Hence, the directors can take the result of this research as a tool to make better decision, particularly related to the board composition policy. LITERATURE REVIEW Corporate Governance Corporate governance definition varies depending on the author, institution, legal and country condition. According to

OECD (2004) corporate governance is a batch of rules that set the relationship between the 18

company stakeholders (i.e. shareholders, creditors, managers, government, and other internal and external party related to the company). This system direct and control the company in terms of the right and obligations among stakeholders. Al-Abbas (2009) defines the corporate governance as the solution to problems arise from effort to align each stakeholder's interest. The reduction of this problems will increase the company performance. Velnampy (2013) said that the corporate governance designed as a system comprising of procedures, mechanism, and structures with the principles of accountability intended for the management of the company in which can improve performance of the company in the long term. As of the various description mentioned above, can be concluded that corporate governance is a system, rules, and principles created to administer the interest between stakeholders so that the company can perform better. Agency Theory

Agency theory focuses on the relationship between manager and owner. Intervention of the 55

board is needed

in order to reduce the agency conflict between managers and owners. The 13

shareholders have limitations such as cost and capability to always monitor the management. Therefore,

board of directors is appointed by the shareholders to monitor the managers 87

(Herdhayinta, 2014). The more independent directors' proportion on board will reduce the opportunistic behavior of the managers, hence increase the monitoring process (Nicholson & Kiel, 2007).

Carter et al. (2003) also added that the independence of the board 21

can be increase through board diversity. The more diverse the background of the directors will bring various issues that the homogenous board normally will not, hence the board will be more active to monitor the management. Moreover, CEO needs independent oversight since the CEO may have influence on the board of directors. A diverse board will be expected to have conflict that associated to occur within a diverse group, which will provide better control

that can be used to reduce agency problem 12

(Erhardt et al., 2003). Stewardship Theory Under the stewardship theory, managers basically

want to do a good job and become good corporate asset servants. Davis 75 et al. (1997) suggests that, the stewardship behavior is generally pro- organizational, meaning their behavior is less individualistic. As stewards, managers strive to achieve organizational goals, therefore their interest will not be separated from shareholder decisions. In this case,

managers are motivated by a desire to achieve intrinsic satisfaction in **performing challenging tasks** 41

rather than monetary considerations (Patrick et al., 2015). To maximize shareholder profits, managers need to act more independently. Thus, the stewardship theory suggests that the performance of managers depends on the structural situation in which they are located; whether it can facilitate their actions or not. Therefore, the key issue is whether organizational structures help managers

to formulate and implement plans for high corporate performance. 32

The focus of the stewardship theories is to

facilitate and empower rather than monitor and control. 106

(Patrick et al., 2015; Donaldson &

Davis, 1991; Davis et al., 1997). Furthermore, **Davis et al. (1997)** 57

also suggested that the five essential components of stewardship

are: trust, open communication, empowerment, and **long-term orientation and performance enhancement.** 53

Corporate Governance in Indonesia A poor implementation in corporate governance practice already taken impact in the past history of Indonesia. The severe financial crisis in 1997-1998 caused by several factor, economic instability is indicated to become the most prominent. Moreover, poorly governed corporations extended the impact of the financial crisis in the country (Claessens & Fan, 2002). Hence, it is urgent for Indonesia to comply with the international best practice of corporate governance (International Finance Corporation, 2014). Nowadays, the task of promoting the good practice of corporate governance is done by

Indonesian Financial Service Authority (Otoritas Jasa Keuangan). OJK 110

collaborate with International Financial Advisory services to create the corporate governance manual that includes the framework of good

corporate governance with the intention of creating a 35

more stable financial situation. The manual covers

various aspects of corporate governance including the enhancement **of** 14

disclosure, transparency, role of board of director, substantial corporate transaction, internal control, as well as the right of shareholder (International Finance Corporation, 2014). Two Tier Board Structure Same as countries such as China, Finland, Netherland, and Germany, Indonesia also divide the board structure into two-tier (Weimer & Pepe, 1999). This means

that the separation of CEO and chairman role in **the** 34

company is needed (OECD, 2017). Indonesian law oblige companies to have two boards in the structure of organization, namely board of managements and board of commissionaires (Darmadi, 2010). Board of commissionaires duties is also called as the business oversight because the obligation to monitor growth, survival, the company's practice of business, as well as advising the board of managements. More importantly, board of commissionaires hold a strategic role to supervise the formulation and implementation of policies by the company management team (OECD, 2017). The members may be affiliated (non- independent) or unaffiliated (independent) with the 1

company (Darmadi, 2010). In contrast, the board of managements

act as the representative of the company, internally and externally. Moreover, they act as the company 58

agent act as the manager and supervisor of company assets. Thus the board of managements is fully responsible to the

day-to-day controlling of the company (OECD, 2017). The two 32

boards has different members and duties, so that the debatable duality problem exist in the single tier board structure can be eliminated (Darmadi, 2010). For public listed companies, the sample of this research, must comply with all applicable laws and regulations (Asian Development Bank, 2013). The five current applicable laws require 30 percent of total board of commissionaires to be independent, as well as minimum one member of board of managements to be unaffiliated (Darmadi, 2010). The directors have a maximum of 5- year appointment period (OECD, 2017). Furthermore, in this study where the sample used is from the Indonesia, then there are several terms in the variables used will be adapted to the context in Indonesia. The board of commissionaire is considered equivalent with the

board of directors (chairman). While, the board of managements is considered equivalent with the 68

CEO. Therefore, not to be confused that this paper would like to discuss only about the board of directors not the CEO. Board Diversity It is believed that the benefits of diversity on the board are a broader perspective, successful marketing for different types of markets, innovation and creativity

(Cox and Blake, 1991; Robinson and Dechant, 1997). Carter, et al. (2003) stated that as the 7

marketplace becoming more diverse, better understanding can be obtained by the board diversity. A diverse board also believed to reduce the group- think phenomenon, where the board effort to achieve agreement taken over the ability to see alternative actions, as the negative effect of non-diverse board (Ujinwa, et al., 2012). On the other hand, Cox and Blake (1991) also states that communication and interpersonal problems or conflict, may become a potential costs to the organization, as a result of the diversity of senior management members. Moreover, an increased cost associated to the time to make decision, as well as the problems coordination especially in competitive environment are possible to happen due to the diversity on board (Smith, et al., 2006). Despite the positive and negative outcome that may arise in the implementation of diverse board, company should take action to reduce the negative outcome while maximize the positive ones. The method for distinguishing between unobserved and observed attributes can be used to categorize different proxy of diversity. Unobserved or also known as the

underlying attributes, including cognitive characteristics such as education, employment, professional background and personal values. 1

On the other hand, observed attributes are the easily detected matter including

demographic characteristics such as gender, race, ethnicity, and age (Milliken & Martins, 1996). 63

According to Erhardt et al (2003) most research focused on observed attributes of diversity. However, change can be made in different orientation on organizational issues and interaction styles with unobserved attributes of diversity (Milliken & Martins, 1996). Researcher can use single or multiple proxies of

diversity in the study of board diversity. 119

The most widely used proxy for diversity is the gender diversity on board. Race or ethnicity

(Carter et al., 2003, Erhardt et al., 2003, Richard et al., 2004), nationality (Oxelheim &Randoy, 2

2003), and

age (Kilduff et al., 2000; Siciliano, 1996) 4

are among

other observable attributes that have been studied in the previous literature. 1

Attention to the unobservable proxy of diversity were rarely seen on the study by previous research such as, occupational funds (Goodstein

et al., 1994), educational level (Herrmann & Datta, 2005, Smith et al., 1994), and tenure (Hambrick et al, 1

1996; Tihanyi et al, 2000). This research will use three explanatory variables for the board diversity, which are women on board, foreigners on board, and education on board. Women on Board Previous researchers such as Campbell & Minguez-Vera (2008) proxies the

board diversity in terms of the gender diversity on board. Greater gender diversity have a tendency to 60

benefit the company according to several arguments by researchers. Creativity and innovation can be increased as the result of gender diversity (Campbell & Minguez-Vera, 2008). Khrisnan and Park (2015) suggest that women are considered “tough”, which gives them a great environment respect. Hurst et al. (1989), stated that women are focused on harmony as they considered to have a “feeling” of cognitive style. Moreover, it is believed that as the part of their behavior, women can facilitate the distribution of information (Earley & Mosakowski, 2000). In contrary, there are several arguments that against the diversity on board, even harmful to companies. It may bring

slow decision-making process (Hambrick et al., 1996), 1

risk response difference (Jianakoplos & Bernasek, 1998)

increase the probability of conflict (Joshi et al., 2006). 4

High turnover and absenteeism of women also contribute to increase on firm cost (Cox & Blake, 1991). Moreover, a diverse group will increase the likelihood of conflict and less cooperative (Earley & Mosakowski, 2000), as well as they are less likely to have more frequent communication and also less likely to share common opinion (Williams & O'Reilly, 1998). Therefore, can be concluded that the previous researches have a mixed finding regarding the positive or negative effect to the company. In current real world condition, the number of women pursuing career in managerial position are increasing. However, the

percentage of women representation on board 125

are relatively low (Omar & Davidson, 1989). According to

Equal Opportunity for Women in Workspace Agency, in 2009 the percentage of women on board in 1

developed country such as Canada, United States, United Kingdom, and 98

New Zealand are respectively 14%, 15.2%, 9%, and 8.7%. These data are showing an increase in general compared to the preceding year's data for the same countries, 13%, 14.8%, 8.5%, and 7.1%. Even if the data shows increase in women participation on board in general, the survey conducted by Spencer Stuart (2016) showed that almost 75% of the respondent deny to support the boardroom diversity quota. This concluded that the according to the directors, the diversity on board should not be mandatory but voluntarily. Foreigners on Board Aside from the diversity in terms of gender, the view of board as collective body of key expertise and background representation are increasingly needed. Therefore, several large companies have appointed foreign board member from the company's important markets (Virtanen, 2009). The

diversity of citizenship **and culture of** members of **the management team** 1

varies in opinion from researchers. Some researchers believe that citizenship diversity can

increase the possibility **of cross-cultural communication** problems **(Lehman & Dufrene, 2008), and interpersonal** conflict **(Cox, Jr., 1991).** 1

Hence, it will make the board operate less effectively. However, a competitive advantage to the company such as, international linkage, shareholder right commitment, and managerial entrenchment avoidance can be obtained from the presence of foreign nationals (Oxelheim & Randoy, 2003).

Foreign investors have the opportunity to purchase larger **shares in the company** 7

as the globalization of business increases 4

(Oxelheim & Randoy, 2003). Moreover, according to Cox, Jr. (1991) management team are increasingly diverse in terms of cultural background. Emerging markets are currently enjoying capital inflows from foreign investors.

Companies with large amount of **foreign investors are more likely to** 28

have a heterogeneous citizenship of board member. Unluckily, the research that link the foreigners on board and the corporate

financial performance in the emerging markets **is very** 4

rare (Darmadi, 2010). Educational Diversity on Board There is a need for greater diversity at the board level. People from non- commercial environments such as the military, academia, and certain professions, also find it difficult to access a scale

of non- executive directors due **to** a combination **of** laziness **on the** part **of the company** 47

and the inappropriate candidate's experience (Fidanoski, et al., 2014). There is a need for diversity where board have made conventional promises. Where suggestions can often benefit from a well-trained and inquisitive mind who can see different things and therefore help advance board thinking (Waine & Green , 2012). Research in psychology shows that the diversity of education in problem-solving groups improves performance. Putting many MBAs in a room and reaching a lower solution, and reaching them slower than if the MBA with lawyers, accountants and engineers (Dobbin & Jung , 2011) are mixed. Educational and intellectual attainment in boards, measured by the presence of executives with PhD degrees, is associated with a decrease in risk taking (Berger, et al., 2012). Moreover, highly educational directors would likely to enjoy social ties to other directors, government officials, executives, which may bring resources, information, and knowledge that may be beneficial for the company (Kumar & Zattoni, 2013).Therefore, educational diversity is an interesting field for many researchers (Bathula, 2008; Coffey & Wang, 1998; Herrmann & Datta, 2005). Measurement for Board Diversity In this research, there are three explanatory variables for the board diversity, which are, women on board, foreigners on board, and education on board. The measurement for each variable will be using the ratio of each category on board. The formula for proportion measurement of each variable will be shown below.

= = 27

ℎ ℎ = However, ratio calculation alone is not suitable to measure diversity, since the higher the proportion measurement will indicate homogeneity instead (Campbell & Minguez-Vera, 2008). Hence, second measurement using Blau Index as the index of heterogeneity is introduced. The index was first introduced Peter M. Blau in 1977. Index is included in the measurement of the proxy to indicate the heterogeneity level of the proxy in the regression (Fidanoski,et al., 2014). The formulation of Blau Index is computed below: = 1 − ∑ 2

=1 Where Pi2 is the percentage of board members in each category and n is the total number of 9

categories used, in this case the category is male or female. The

minimum value of the index is 0 and the maximum value is 0, 12

5. Therefore this index would display whether or not the proxy is balanced (Kilic & Kuzey, 2016). The more balanced the proxy, will indicate that the company is actually heterogeneous.

Return on Asset ROA is a widely used indicator of profitability of a firm. 97

ROA is classified as the accounting based measurement of financial performance (Masa'deh, et al. 2015). It shows a measurement of income produced as a return of the resources used to generate that income. Hence, the positive result of ROA meaning that the asset owned can generate income for the company. ROA has been used in numerous studies regarding the board diversity (Kilic & Kuzey, 2016; Fidanoski

et al.. 2014; Mahadeo et al., 2012; Darmadi, S., 2010). Mahadeo et al. 76

(2012) research concludes that the board diversity have a positive influence towards ROA. Moreover, Fidanoski

et al. (2014) also research the relationship between ROA and 39

board diversity. The result conclude that women on board and education on board have a positive impact towards ROA, while foreigners on board have a negative influence towards ROA. The Return on Assets measure is formulated below: Net Income = Total Asset

Tobin’s Q Corporate value is an important measure of 11

shareholder value (Gill & Obradovich, 2012). Company value

is defined as the market value of the 5

company because it can provide prosperity for investors / shareholders if stock price increases. High stock prices indicate that the value of the company is also high (White, et al., 2003). High corporate value will be followed by the level of prosperity of investors and owners. The value of shareholders

will increase if the value of the firm increases as indicated by the high return of 65

investment to shareholders (Sujoko & Soebiantoro, 2009). One way to calculate corporate value is by calculating Tobin's Q ratio developed by James Tobin (1969) and assessed to provide the best information, because this ratio can explain various phenomena occurring within the company

such as cross sectional differences in investment decision making. The value of 85

Tobin's Q describes a condition of investment opportunities owned by the company or potential growth of the company (Lang, et al., 1989).

Tobin's Q is generated from the sum of market capitalization and total debt 59

compared to the total equity of the firm, then

Tobin's Q can be used to measure the company's 15

performance that is in terms of potential market value. Companies

with a high value of Tobin's Q or 67

> 1.00 will be more attractive to investors and have good investment opportunities. Conversely, if Tobin's value q <1.00 illustrates that the stock is under undervalued condition which means that management has failed to manage the company's assets and the potential for low investment growth so that investor interest

is low to invest (Kim, et al., 1993). 115

Tobin’s Q is also used as the financial performance measure of the 6

previous research such as Gordini & Rancati (2017), Fidanoski

et al. (2014), Ahern and Dittmar (2012), Darmadi, Salim (2010), and 113

Campbell & Minguez- Vera (2007). The

Tobin's Q formula developed by (Chung & Pruitt, 1994) can be formulated as 79

follows:

' = + + Where: TQ = Tobin’s Q MVE = Market Value of Equity (Share price at the end of year times amount of outstanding ordinary shares) PS 8

= Preferred Stock Debt = Total short

term debt TA = Book value of total assets Control Variables 8

The control variable used in this research are

firm size (from natural log of the total assets), leverage, and board independence. The size of 61

the firm will affect the financial performance, as the bigger firms will have several advantages compared to the smaller ones

(Carter, et al., 2003; Adams & Ferreira, 2009). Leverage ratio is used to control the impact of 5

debt servicing on profitability and wealth (Enekwe et al., 2014). Leverage creates a potential risk and reward to the company, thus it will affect the financial performance (Obonyo, 2015). Companies with no financial scandal tend to have higher number of independent directors (Beasley, 1996).

Studies suggest that a relationship is found between the independence of the board 107

and improvement of financial result (Baysinger and Butler, 1985; MacAvoy and Milstein, 1999). Research

Hypothesis Relationship of Women on Board to Financial Performance The gender diversity of corporate

boards has been the subject of intense exploration in 103

various studies. Hence, there are many studies, which show different results. Of particular interest is quantitative

research on the impact of gender diversity on company performance. 84

Carter et al. (2003) suggests a positive relationship between the gender diversity of the board and firm value, as measured by Tobin's q. 13

This result also supported by some other research by Campbell & Minguez-Vera (2007), and Gordini & Rancatti (2017). In contrast, Farrell & Hersch, (2005), Miller & Triana (2009) stated that they find no strong evidence or show some negative effects (Adams & Ferreira, 2009; Ujinwa

et al., 2012). On the other hand, the research from Mahadeo et al. 77

(2012), shows

a positive link between gender diversity and ROA. 96

Kilic & Kuzey (2016), Fidanoski et al. (2014) also agree to the finding of positive impact on ROA. Previous

empirical research on the effect of board diversity on firm performance is inconclusive, and the results depend heavily on the methodology. Different results reflect time, country, economic environment, type of company, and the size of diversity and different financial performance. The relationship between board characteristics and company performance may vary by country, due to different regulatory and governance structures, economic and cultural constraints, and the size of the capital markets 3

(Rhode & Packel, 2010). In Indonesian context, where majority of the

listed companies are family owned, the existence of women on 90

board are mainly because of the family relationship instead of the actual professional expertise of the person. The lack of ability of women on board would negatively affect the corporate financial performance (Darmadi, 2010). Therefore, the following hypothesis is made. H1a. The gender diversity

negatively related to return on asset (ROA) H1b. The 121

gender diversity

negatively related to corporate Tobin's Q Relationship of Foreigners on Board 37

to Financial Performance Researchers still rarely observe the

relationship between the board member nation's diversity and the company's financial 105

performance in emerging market scenarios.

Evidence of the linkage between diversity and financial performance 88 most come from emerging economies. The results of previous empirical evidence are ambiguous. Most empirical studies

are based on US and UK data, and only from the 26

largest companies. The results of these studies show diverse conclusions. Empirical research on the composition of board citizenship in England shows the slightest diversity. Only 7% of directors are not British, only 1% of minority ethnic groups (Burmajster, 2009).

Oxelheim and Randoy (2003) examine the effect of diversity of foreign board members on the value 5

of firms

in Norway and Sweden, and the results show significantly higher performance for firms with foreign board 40

members. In addition, Barta, et al., (2012) explored the composition of councils, women and foreign nationals in the senior team, ROE, and profit margins

before interest and taxes from 180 public companies in France, Germany, the United Kingdom and the United States during the period 2008 to 2010. They document that companies 19

with diverse executive boards enjoy significant revenue and ROE. Similar results were also presented by other researchers who examined this field (Ruigrok, 2009; Ujinwa et al., 2012). Along with these lucrative studies are those that show different results. This study shows that foreign directors are associated with less important company performance (Masulis, et al., 2012), or find no significant relationship with financial performance (Fidanoski, et al., 2014; Rose, 2007; Shan & Xu, 2012). For Indonesian context, data from Darmadi (2010) showed that in average 8,9% of board seats are foreigners. This

due to the high proportion of foreign ownership in some firms. Foreigners on 1

board will be

more likely to draw the interest of foreign investors, as the 35

foreigner directors will protect their interest (Oxelheim & Randoy, 2003). The more foreign investors invest

in the company, will have positive impact to the financial performance 112

(Darmadi, 2010). Aside from that, the foreigners can also possess different way of thinking, knowledge and insight that will result in better decision making and policy that will be favorable to the financial performance (Kumar & Zattoni, 2013). Following many other

research related to the nationality of board members with corporate performance, the 6

hypothesis are constructed below: H2a. The national

diversity is positively related to firm’s 117

return on asset (ROA) H2b. The national

diversity is positively related to firm’ s Tobin’s Q Relationship of 2

Education on Board to Financial Performance Some research found that the

number of board members with PhD level education was positively related to 10

firm performance (Fidanoski,

et al., 2014). On the other hand Bathula (2008) find that PhD level 34

education is

negatively related to corporate performance, while Fidanoski et al. (2014) suggest there is no significant relationship between the ratio of education and 16

bank performance. The previous research related to the education on board and financial performance is showing a mixed results. Nevertheless, eligible board members with a PhD degree can be considered as the most valuable strategic source of the company

(Ingley & van der Walt, 2001). Board members with PhDs will ensure effective councils with high levels of intellectual ability, experience, level of assessment, and integrity. 10

Better qualification of board members will improve company performance and competition through professional expertise and proficiency (Duniffy & Cooke, 2002). With this argument, the following hypothesis is made: H3a. The educational

diversity is positively related to return on 118

asset (ROA) H3b. The educational

diversity is positively related to Tobin's Q 2

RESEARCH METHODOLOGY This research is conducting an analysis using multiple regression test. The regression test consist of the variables stated below; a. Women on Board as the first independent variable which measured with proportion and Blau Index. b. Foreigners on Board as the second independent variable which also measured with proportion and Blau Index. c. Education on Board as the third variable measured with the proportion and Blau Index. d.

Financial performance as the dependent variable 11

measured with

return on asset (ROA) and Tobin's Q. Sample Criteria Number of Observations Population of 22

manufacturing companies listed in Indonesian Stock Exchange in 12

2015 142 Companies that fail to meet the criteria as the sample (37) Number of companies that fulfills the criteria 105 Total Samples (105 x 5) 525 e. Firm size (FSIZE), Leverage (LEV), and board independence (BIND) as the control variable. The model of analysis are as follows; = 0 + 1 + 2 + 3 + 4 + 5 + 6 + ℰ = 0 + 1 + 2 + 3 + 4 + 5 + 6 + ℰ = 0 + 1 + 2 + 3 + 4 + 5 + 6 + ℰ = 0 + 1 + 2 + 3 + 4 + 5 + 6 + ℰ This research analysis uses secondary data obtained from the published annual report, sustainability report, Bloomberg, and publicly available information in the media. The data is chosen based on certain criteria from 5 years observation. The criteria on sample selection are; a. The company should be publicly listed and traded in the Indonesia

Stock Exchange and operates in consumer goods sector in manufacturing industry. 94

b. It produces complete annual report from year 2011 until 2015. c. It produce report related the board of directors. d. It published annual report's figures are in Rupiah. e. It published financial statements' figures should show 1-year figure. Table. 1 summarizes the total data

sample used in this research paper. Table 1. Data Sample 29

Summary Source: Author's Compilation RESEARCH RESULT AND ANALYSIS Descriptive Statistics The analysis of descriptive statistics summarize the total number of data, minimum and maximum value,

as well as the standard deviation of the variables used in 52

this paper which will be shown below in table 2. Table 2. Descriptive Statistics Source: SPSS Output Regression Test This research is using four models to describe

the impact of the board diversity to financial performance. Therefore the 104

regression test will be conducted four times. The regression test will be conducted using R-Squared Test. This test will

identify the influence of independent variable to explain the dependent variable. The 80

summary of regression test will be shown below

in the Table 3. Table 3. Summary of 122

R-Squared Test Result

Model R Square Adjusted R Square Std. Error of the Estimate 1 0, 341 0, 333 5,56008 2 0, 432 0, 36

334 5,55622 3 0,614 0,609 0,30399 4 0,618 0,612 0,29283 Source: Author's Compilation In test result above can be seen that model 1 has the

R-Square value of 0,341. Meaning that 34,1% 102

of the dependent variable

can be explained from the independent variable used in the model. The rest 29

65.9% is determined by other factors that is not explained in the model. Moreover, the result for model 2, 3, and 4, are respectively, 42.2%, 61,4%, 61,8%, of the dependent variable influenced by the independent variable that exist in each model. Hypothesis Test Significance level of 5% is used in this research. The T-Test that conducted on the four models existed in this research resulted in the four out of six hypotheses are accepted due to the significant value more than 5%. Table below will show the

summary of the hypotheses test result. Table 4. Summary of Hypotheses 99

Result

Source: Author's Compilation Table 5. Summary of 45

T-Test

Source: Author's Compilation From the 45

table above can be shown that the variable women on board measured with proportion has the significant value of 0,001 and negatively affecting ROA, as the β score is -4,693. Women on board measured with Blau Index has significant value of 0,000 and also negatively affecting ROA, as the β -4,661. Thus hypothesis H1a is accepted. Foreigners on board measured with proportion and Blau Index respectively has the significant value of 0,008 and 0,007. This variable is positively affecting ROA with β of both measurement respectively 2,950 and 3,467. Hence hypothesis H2a is accepted. The third variable of education on board measured with both proportion and Blau Index has significant value respectively 0,082 and 0,246 towards ROA. Which make the hypothesis H3a is rejected. Women on board measured with proportion has significant value of 0,319 concerning Tobin's Q. While measured using Blau Index has significant value of 0,039 and negatively affecting Tobin's Q, as the β score is -0,152. Therefore, hypothesis H1b is accepted. Foreigners on board measured with proportion and Blau Index respectively has significant value of 0,000 and 0,001. Foreigners on board

is positively related to Tobin's Q as the β value of 2

both measurement respectively shows 0,329 and 0,252 score. Hence hypothesis H2b is accepted. The last but not least, education on board shows significant value of both measurement respectively 0,039 and 0,003. This variable shows negative relation to Tobin's Q, as both measurement shows β respectively, -0,265 and -0,277. Which conclude that H3b is rejected. Result and Theory Explanation

Relationship between Women on Board and ROA The result of 89

this research shows women on board measured by both proportion and Blau Index have a negative effects towards return on asset (ROA), hence the hypothesis H1a is accepted. The higher the

proportion of women on board will lower the return on asset. The 101

higher the evenness of women and men on board will also lower the return on asset. Negative correlation of women on board and return on asset is in accordance with previous studies by Darmadi (2010) which found that women on board has negative significant result towards return on asset. According to the result of Darmadi (2010) the condition of

listed firms in Indonesia are mainly family controlled, 1

the women that present on board are more likely compelled by the family relationship rather than the actual competence of the person. Thus, will be more likely that the female directors have lack of necessary skills, expertise and, experience to conduct their responsibilities as directors. This lack of competence will result in a poor

decision making process, and eventually will negatively affect the firm performance which is in this context is the 56

return on asset (ROA). Figure 1. Women on Board and ROA Data Graph Source: Author's Compilation Table 6. Women on Board and ROA Data Source: Author's Compilation Figure 1 is shown to understand the relationship of this two measurement further. From the figure 1 shown above, it is clear that the women on board

have a negative correlation with ROA. The higher the 38

proportion and Blau Index measurement will result in lower ROA. Therefore, according to this research, it is better not to have female directors if a company want to have a good financial performance

in terms of ROA. Relationship between Foreigners on Board and ROA The 108

result of this research shows that foreigners on board measured by both proportion and Blau Index has shown a positive impact, therefore the hypothesis H2a is accepted. The higher the proportion of foreigners on board will increase the return on asset. The higher the evenness of foreigners and Indonesians on board will also increase the return on asset. Positive correlation of foreigners on board and return on asset is in accordance with previous studies by Choi,

et al. (2007) which found that foreigners on board has a positive significant result towards 7

return on asset. Choi, et al. (2007) using the sample of Korean banks finds that foreigners that exist on board will be expected to take along competitive advantages towards the company. These competitive advantages is in the form of international networks, shareholder rights commitment and broader international perspective. These competitive advantage will in turns make the firm operates more efficient and effective and therefore will leads in a better performing firms. The better performance can be interpreted as the higher income of the company. Hence, a higher return on asset (ROA). Figure 2. Foreigners on Board and ROA Data Graph Source: Author's Compilation Table 7. Foreigners on Board and ROA Data Source: Author's Compilation From the figure

2, foreigners on board will have a positive impact towards return on 71

asset. The measurement of both proportion and Blau Index have a positive impact to ROA. The higher the number of foreigners on board should be better to the return on asset measurement. However, the research is talking about whether or not the diversity or heterogeneity is needed on board. The higher number of foreigners relative

to the number of directors on board will eventually turn the board 14

into a homogeneous board instead of heterogeneous. Therefore, a second measurement of Blau Index is introduced to measure the degree of evenness of the variable (Campbell & Minguez-Vera, 2008). According to the data above, the higher the Blau Index, the higher the return on asset. A high Blau Index is not the same with the high proportion. Take the data from RMBA 2011 for example, 80% of the board is a foreigners. However, the Blau Index measurement shows a lower score compared to data from BATA 2011 where the proportion of foreigners is only 60%. This data suggest that in case of both proportion and Blau Index shows a positive correlation, it is better to the company to have an even amount of foreigners and Indonesian directors. Relationship between Education on Board and ROA Observing the result of the data analysis, the result of both measurement of proportion and Blau Index has the same result which is not statistically significance, resulted that hypothesis H3a is rejected. The change in proportion of PhD holder as well as the degree of heterogeneity of PhD and non-PhD holder on board will not have any impact towards the financial performance of the company measured with return on asset.

This result is not consistent with the previous researches conducted by 93

Hilmer (1998), as well as Carpenter and Westphal (2001) which shows a positive relationship. However, the

result is in line with the study conducted by Fidanoski, et al 92

(2014). Using Macedonian firms sample in banking industry, the study shows that the PhD holder

does not have effect to financial performance measured with the return on 5

asset ratio. The reason is because the PhD degree they have is on the field that is not suitable with the nature of business field of the company. For example, the director have the degree in political science, while the company operates as a steel manufacturing company. Therefore, the PhD degree they have will not directly give the necessary competence to have a competitive advantage regarding their company operations. Eventually this condition will result in no effect towards the return on asset. The

board diversity in terms of education 124

of the directors is measured using two measurement. To make it easier to understand the implication of the result of both measurement, several data is show in figure 3. Data shows that the effect of education on board to return on asset is not significant on both proportion and Blau Index measurement. Therefore, this study suggest that adding more PhD holder directors to the board will 23

not have any effect to financial performance measured with return on 5

asset. Figure 3. Education on Board and ROA Data Graph

Source: Author's Compilation Table 8. Education on Board and 44

ROA Data Source: Author's Compilation Relationship between

Women on Board and Tobin's Q. The statistical analysis of 20

women on board and Tobin's q 17

has a mixed finding. The result using proportion measurement shows that there is no significance towards Tobin's q, meaning

that the increase in in number of women on board 86

will have no effect to financial performance of the company measured

with Tobin's q. This result is not consistent with 6

the result from the previous result conducted by Darmadi (2010) which shows a

negative relationship to Tobin's q. However, this result is 31

agreed with Farell & Hersch (2005) where their studies shows that no strong evidence in this

relationship between women on board and financial performance measured 95

with Tobin's q. They

find that the presence of women on board that does not have any significant 43

difference with the presence of men on board since the women tend to follow the groupthink phenomenon that exist on board. The groupthink phenomenon is a condition where the decision making process and practice of thinking discourage personal responsibility and creativity, hence will eventually bring no change to the company (Farrell & Hersch, 2005). This will further have no effect towards the

Tobin's q. On the other hand, the result of 25

Blau Index measurement shows that there is

a negative relation between the women on board and Tobin's q. 20

Therefore, the hypothesis H1b is accepted. The result means that the higher the evenness or the heterogeneity degree of gender on board will result in lower calculation of

Tobin's q. This finding is consistent with the previous 16

research by Darmadi (2010) where women on board is negatively associated to Tobin's q. Figure 4. Women on Board 37

and Tobin's Q Data Graph Source: Author's Compilation Table 8.

Women on Board and Tobin's Q 17

Data Source: Author's Compilation The more heterogenic the board in terms of gender will have a negative impact, because will increase the possibility of conflict arise, and slower decision-making process. Therefore the higher the diversity will result in increase in cost related to it, for example to resolve the conflict (Darmadi, 2010). The higher cost incurred, will also be followed with a poor decision making process, that eventually will affect the

firm financial performance in terms of Tobin's q. From the figure 4 where the 46

data is taken from this study,

proportion of women on board have no significant impact to 38

Tobin's q. For example, TPIA 2013 with 14,28% women on board have a higher Tobin's Q measurement compared to TSPC 2013 that have 66,67% of women on board. Moreover, the more even the proportion of women and men measured with Blau Index resulted in decrease in Tobin's Q measurement. This result suggest that diversity in terms of gender is not recommended since it will have

a negative effect to the financial performance in terms of Tobin's q. Relationship between Foreigners on 51

Board and Tobin's Q The

result of the study shows that foreigners on board have a positive correlation on 72

both proportion and Blau Index measurement. This will result in the acceptance of H2b where foreigners on

board is positively related to Tobin's q. The higher the number of 18

foreigners on board will make the

Tobin's q higher. Moreover, the higher the degree of heterogeneity of 15

foreigners and Indonesian on board will also increase the Tobin's q measurement. This

result is consistent with the previous research conducted by Ararat, et al. (2010) using the sample of Turkish firms, 42

stated

that higher level of nationality diversity on boards 4

leads to higher Tobin's q. The foreign ownership have an important role in company performance, especially in the

developing countries (Ararat et al., 2010). 4

This findings also supported by Darmadi (2010), stated that Indonesia have a relatively high proportion of foreign ownership in several firms. Foreign owners will be more likely to have the capability to give a performance-based incentives that will make the managers to manage the company more seriously and discourage activities that will damage the shareholder wealth creation (Ararat et al., 2010). Eventually it will increase the

financial performance of the firm in terms of the 69

Tobin’s q. Figure 5 shows that both proportion and Blau Index measurement have a positive impact to the

Tobin’s q. This result is similar to the result **of** 31

foreigners on board to return on asset. The higher the proportion of foreigners should have resulted in a higher measurement of Tobin’s q. However, the data shows a higher degree of evenness of both variable will have a better result of Tobin’s q. This research suggest that the company should have a even number of foreigners and Indonesian on board to have a better measurement of Tobin’s q. Therefore, a diversity in terms of nationality is needed. Figure 5. Foreigners on Board and Tobin’s Q Data Graph

Source: Author’s Compilation Table 10. Foreigners **on** Board **and** 44

Tobin’s Q Data Source: Author’s Compilation Relationship between Education

on Board and Tobin’s Q Noticing **the** result **of** this study, **the** 17

result of education on board using both proportion and Blau Index are showing a negative correlation to Tobin’s q. Therefore, can be concluded that hypothesis H3b is rejected. The higher the proportion of PhD holder board member will result in the lower

Tobin’s q. Moreover, **the higher the** degree **of** heterogeneity **of** 15

PhD holder and non-PhD holder on board will also result in lower

Tobin’s q measurement. **This result is** different **with** the **previous research** 83

from Fidanoski et al. (2014) which found that education diversity on board

have a positive **impact** to **Tobin’s q.** However, **the** result **is** 2

agreed with the previous study by Bathula (2008) using the sample of New Zealand firms shows the similar result that PhD level education on board

have a negative relation to **Tobin’s q. The** presence **of** 100

directors with PhD degree is linked with a lower risk taking ability. The board is become more modest because the reliability on more evidence to make a decision. The lower the degree of risk taking will make the firm more likely to be left behind in the ever-dynamic business environment. This will result eventually in the lower measurement of Tobin’s q of the company. Figure 6. Education on Board and Tobin’s Q Data Graph Source: Author’s Compilation Table 11. Education on Board and Tobin’s Q Data Source: Author’s Compilation Figure 6 above also suggest a negative correlation of education on board to Tobin’s q. This study suggest that more PhD holder on board will have

a negative effect to the **Tobin’s q.** 123

Therefore, it implies that the diversity in terms of education is not needed. CONCLUSION AND SUGGESTION The purpose of the research

is to find **the impact of board diversity** to **financial performance of** 30

Indonesian listed manufacturing companies that published the annual report for the year 2011-2015. The independent variable of board diversity is using three variables which are women on board, foreigners on board, and education on board. Moreover, each variable is measured using two measurement, namely proportion, and Blau Index because using proportion alone will result in homogeneity rather than heterogeneity. This research can show whether or not the diversity on board is beneficial and needed for the company that conducting it. Hence, the policy makers of the company can use this research as one of the decision making tools, especially policies related to the board of directors and diversity. Furthermore, this research will also beneficial for the potential investors to

consider the implementation and importance of corporate governance in their 91

investment decision.

This study will also contributes to the existing literature of the impact of 64

board diversity to financial performance in Indonesia. The 120

total number of observations in this research are 525 sample from 105 firms that publish the annual report in the year 2011-2015. All the data used in this research is taken from the information that is publicly released.

Based on the research result and the detailed analysis explained in chapter 4, 28

the

impact of board diversity to financial performance can be 114

summarized as follows. 1. Women on board has negative effect to return on asset. 2. Foreigners on board has positive effect to return on asset. 3. Education on board has no effect to return on asset. 4. Women on board has negative effect to Tobin's q. 5. Foreigners on board has positive effect to Tobin's q. 6. Education on board has negative effect to Tobin's q. There are several suggestions that can be given for the future research in regards on topic of board diversity and the impact to financial performance: 1. The current research only focus to the listed manufacturing companies in Indonesia. Therefore, the observation cannot cover the findings of the

impact of board diversity to financial performance in listed company in 11

Indonesia as a whole. Future research should include the other industry such as non-manufacturing in industries in Indonesia to promote the generalizability of the findings. The research is only using the manufacturing industry as the sample, which is account for around 30% of the total listed companies in Indonesia so the data that is gathered will be more reliable and reflect the actual condition in Indonesia. 2. This research only use three variable to describe the diversity on board. Therefore, many other factors of diversity that may be significant are not taken into consideration to measure the relation of diversity towards the financial performance. Future researchers can consider to add different variables such as age, ethnic background, family ties and other variable that may be proven significant that is not considered in this study to give a broader picture regarding the board diversity. REFERENCES Agrawal, A., & Knoeber, C. (1996). 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