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Women Directors and Cost of Debt

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Abstract

Calling for a gender-balanced board has become a global trend since a few decades ago. Malaysia envisions to have at least 30 percent of women directors in board of directors by 2020 and making mandatory for large listed firms to take the lead since 2017. On the other hand, bank loan is one of the main sources of finance to Malaysia listed firms. On top of that, cost of debt plays a significant role when firms considering debt finance. Fortunately, it can be reduced through corporate governance mechanism, namely a gender-balanced board. Nevertheless, the empirical evidences on the relationship between gender-balanced board and cost of debt based on emerging markets including Malaysia remaining scarce up to date warrant a study. Therefore, a study to determine the relationship between women directors and cost of debt in Malaysia is proposed in respond to the callings. There are a few implications of the proposed study. Firstly, it contributes to the hot debates on how women directors contribute to the board. Secondly, it contributes to the further understanding of different context's outcome, specifically both developed and emerging market. Practically, it sheds light to the regulators and policy makers in setting future corporate governance guideline. Besides that, it also provides insight to nomination committee in recruiting new board member. Lastly, it can become an additional reference to the potential investor when making their investment decision.

Keywords: Agency Theory, Board of Directors, Corporate Governance, Cost of Debt, Women Directors

Introduction

Board of directors (BOD) is the top management to devise, implement and review the strategic direction of a firm (Fama & Jensen, 1983). BOD diversity is a subset of board composition. It is one of the key attributes which determine firms' performance. On top of that, behavioral theory supports a well diverse BOD (Cyert & March, 1963). It is because homogeneous BOD may be a hinderance to innovation due to preference of conformity and group think (Miller & Triana, 2009). On the other hand, heterogenous BOD contributed wider knowledge which result in more innovation ideas and better quality decisions (Hoffman, 1959; Joshi & Roh, 2009). Nevertheless, the impact of BOD diversity is inconclusive. Some researchers found a diversified BOD reduced the effectiveness and efficiency of the BOD 's decision making process seeing more disputes, miscommunication and delayed decision making (Carpenter, 2002; Smith, Smith, & Verner, 2005) due to the need to reconciled different opinions and voices coming from members with different background and culture (Carter, D'Souza, Simkins, & Simpson, 2010; Miller, Burke, & Glick, 1998).

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Past literature studies the effect of BOD diversity based on various demographic characteristics such like ethnic (Abdullah & Ismail, 2016; Abdullah, Maruhun, Tarmizi, & Rahman, 2018; Abdul, Madah Marzuki, Jaafar, & Masron, 2018; Gul, Munir, & Zhang, 2016), gender (Abdullah & Ismail, 2016; Authors, 2015; Badru, Ahmad-Zaluki, & Wan-Hussin, 2019; Hussain, Rigoni, & Orij, 2018; Jubilee, Khong, & Hung, 2018; López-Delgado & Diéguez-Soto, 2018; Low, Roberts, & Whiting, 2015; Omar & Amran, 2017; Poletti-Hughes & Briano-Turrent, 2019; Sheela, Je-Yen, & Rajangam, 2016; Usman, Farooq, Zhang, Makki, & Khan, 2019), religion (Authors, 2017; Čornanič, Novák, & Šarapatka, 2018) and others. Among them, gender-balanced board brought alternative viewpoints (Zahra & Pearce, 1989), mitigated the shortcoming of corporate governance (Gul, Srinidhi, & Ng, 2011), reduced financial reporting mistake and fraud (Wahid, 2018), improved firm ‘s performance (Dezso & Ross, 2012) and contributed to the strategic direction (T. Miller & Triana, 2009).

All of these are mainly due to the fact that gender do influence decision making process in corporate world as men and women are different in their choice and preferences from both economist and psychologists’ point of view (Barber & Odean, 2001; Byrnes, Miller, & Schafer, 1999; Eckel & Grossman, 2008; Rossi, Hu, & Foley, 2017). Women directors contributed to the board in various ways (Hoobler, Masterson, Nkomo, & Michel, 2016). They bring various expertise and experiences than men do. (Hillman, Cannella, & Paetzold, 2000; Hillman, Shropshire, & Cannella, 2007), reconcile the conflict of interest between board members (Fama & Jensen, 1983), understand the market better and leading to better decision making (Carter, Simkins, & Simpson, 2003).

From the stakeholder theory perspective, BOD represents all stakeholders including employee, supplier, customer, lender, regulator, community and whichever party has an interest in the firm. It should no longer solely be accountable to shareholders who are mainly interested in financial information of the firms (Finegold, Benson, & Hecht, 2007). Therefore, BOD portfolio should meet such demands from all stakeholders (Huse, 2005). Thus, introduction of female directors is crucial as they are more alert of non-financial impact such like sustainability (Labelle, Francoeur, & Lakhal, 2015), social and environmental issues (Williams, 2003) and public disclosure. (Gul et al., 2011) They should help in winning the heart of these stakeholders (Bear, Rahman, & Post, 2010; Branco & Rodrigues, 2008) and eventually help the firm to access the valuable resources and creating long term sustainable contribution.

In the past, women directors needed to put in extra effort to be accepted into the board and worked with their peers especially in masculine firms (Eagly & Carli, 2003). They were also pressured to follow their leader rather than challenged the authority and were weak monitors (Usman, Farooq, Zhang, Makki, & Khan, 2019).

Since a few decades ago, calling for a gender-balanced board has become a global especially in those developed market. For example, there are 14 countries that are practicing a gender-balanced board and 16 countries’ code of corporate governance encourage it for listed firms (Terjesen, Couto, & Francisco, 2016). Malaysia is in the former which envisions to have at least 30% of women directors on the board by 2020 making mandatory for large listed firms to take the lead effective since 2017 in view of their significant socioeconomic impact to the country (Bursa Malaysia, 2017).

On the other hand, Risk preference of a firm determined its competitiveness in the industry (Sila, Gonzalez, & Hagendorff, 2016) while indebtedness impacted on its productivity (G. Anderson & Raissi, 2018) and economic growth (Mika & Zumer, 2017).

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Generally, firms preferred to utilize internal fund to meet investment needs and debt financing over equity financing when external funding was necessary (Myers & Majluf, 1984). Actually, debt or equity financing to meet investment needs is always a question of management deliberation (Ghouma, Ben-Nasr, & Yan, 2018). Pecking order theory suggests debt should take priority over equity financing as it is relatively cheaper and enables firms to expand and grow beyond its existing scale which may be restricted by organic accumulated internal generated fund (Frank & Goyal, 2003). On the other hand, trade-off theory raises the concern over cost of debt as one of the main considerations when firms making its financial decision to balance the risk associated with indebtedness, for example restricted covenant, extra disclosure effort and bankruptcy the worst (G. Rajan & Luigi, 1995; Graham, 1996). Despite the arguments aforementioned, bank loan remained as one of the main sources of finance to Malaysia listed firms (Fraser, Zhang, & Derashid, 2006).

Up to date, the influence of women directors towards firm performance has been studied widely in the past (Chapple & Humphrey, 2004; Hewa Wellalage, 2013) with mixed results (Post & Byron, 2015). Majority of the evidences showed gender diversity was significant positively associated with firm 's performance (Adams & Ferreira, 2009; Campbell & Vera, 2010; Francoeur, Labelle, & Sinclair-Desgagné, 2008; Green & Homroy, 2018; Low et al., 2015; Murray, 1989; Post & Byron, 2015; Singh, Terjesen, & Vinnicombe, 2008; N. Smith, Smith, & Verner, 2006; Solakoglu & Demir, 2016) and value (Campbell & Mínguez-Vera, 2008; Carter et al., 2003; Erhardt, Werbel, & Shrader, 2003; Jubilee et al., 2018; Perryman, Fernando, & Tripathy, 2016; Scholtz & Kieviet, 2018) while some evidences showed that there were either small (Konrad, Kramer, & Erkut, 2008), insignificant (Carter et al., 2010; Shukeri, Shin, & Shaari, 2012), none (Pletzer, Nikolova, Kedzior, & Voelpel, 2015) mixed results (Shamsul N. Abdullah, Ismail, & Nachum, 2016) or even negative (Adams & Ferreira, 2009; Ahern & Dittmar, 2012) relationship between women directors and firms' performance.

Nevertheless, the relationship between women directors and cost of debt is inconclusive due to limited empirical evidences up to date. Among them were cost of debt decrease (Ghouma et al., 2018; Usman, Farooq, Zhang, Makki, & Sun, 2019) despite some studies argued that there was no significant relationship associated (R. C. Anderson, Mansi, & Reeb, 2004; Luo, Huang, Li, & Lin, 2018).

Despite a lot of studies being carried out to evaluate the relationship between women directors and cost of debt in developed markets, the relevant studies which based on emerging market is still scarce up to date. Past studies suggested that outcome between developed and emerging market might not be the same due to number of institutional issues (Fan, Wei, & Xu, 2011; Tee, 2018) including less developed legal system and lower information quality (Liu & Lu, 2007), higher information asymmetry (Akhtar, 2017) and unique culture (Costa, Terracciano, & McCrae, 2001) which may lead to the organization and behavior differences. Meanwhile, there are callings from previous literatures to extend the cost of debt research in different context (Hashim & Amrah, 2016), specifically Malaysia. Therefore, a study to determine the relationship between women directors and cost of debt in Malaysia is proposed.

Literature Review

Agency Theory

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The fundamental principle of Agency Theory is the conflict of interest between the owner, namely the shareholders and the agents, namely the management of the firm. shareholders looking for wealth maximation whereas management focus on personal wealth, job security as well as their status (Jensen, 1976).

The conflict of interest may result in the managerial opportunism threat. For example, management might entrench themselves by entering into selected contracts which they are familiar with rather than benefits the firms the most to secure their office (Shleifer, AndreiVishny, 1989). They might also be involved in earning management in real activities manipulation such like perform last minute promotion to increase turnover or overproduction to reduce cost of sales and postpone discretionary expenditures to present a better financial performance (Roychowdhury, 2006), initiate significant corporate events such like Initial Public Offering (IPO) (S. H. Teoh, Welch, & Wong, 1998) or Seasonal Equity Offering (SEO) (S. S. H. Teoh, Welch, & Wong, 1998) and Mergers and Acquisitions (M&A) (Erickson & Wang, 1999). Therefore, debt providers consider such threats and the associated potential risk of default when issue debt by adjusting the cost of debt to reflect the risk embedded (Anderson, Mansi, & Reeb, 2003; Lin, Ma, Malatesta, & Xuan, 2011; Ma, Ma, & Tian, 2017).

Nevertheless, it is believed that agency cost might be reduced and even avoided if firms consolidate its ownership and management, for example in family firm (Chrisman, Chua, & Lits, 2004; Demsetz & Lehn, 1985; Fama & Jensen, 1983; Jensen, 1976) since the alignment of interest between the shareholders and management is much higher (Anderson et al., 2003; Ang, Cole, & Lin, 2000; Daily & Dollinger, 1992).

Besides that, Corporate governance mechanisms also reduced the agency cost (Ghouma et al., 2018; Hashim & Amrah, 2016; Klock, Mansi, & Maxwell, 2005) including cost of debt (Anderson et al., 2004; Bhojraj & Sengupta, 2003; Claessens & Yurtoglu, 2013; Pittman & Fortin, 2004). Among them, BOD's characteristic significant associated with cost of debt (Anderson et al., 2004). Board diversity as one of the corporate governance mechanisms results in better monitoring (Bhojraj & Sengupta, 2003) with critical questions that might not be asked if the BOD are possessing same attributes (Carter et al., 2003) and better disclosure to mitigate information asymmetry problem (Bhojraj & Sengupta, 2003; Ghouma et al., 2018).

Women Directors

Study on gender-balanced board is gaining traction recently as more and more studies showed women directors complement BOD in numerous ways. Women in nature play their role more serious (Schmitt, Realo, Voracek, & Allik, 2008), for instance better prepared (Pathan & Faff, 2013), attended more meeting (Adams & Ferreira, 2009) often assessed board function (Nielsen & Huse, 2010) and promoted higher ethical standard (Terjesen, Sealy, & Singh, 2009). All of these attributes reduced agency cost (Reguera-Alvarado, de Fuentes, & Laffarga, 2017), brought better governance (Adams & Ferreira, 2009; Singh & Vinnicombe, 2004), tougher monitoring (Adams & Ferreira, 2009; Konrad et al., 2008) and improved earning quality eventually (Srinidhi, Gul, & Tsui, 2011). As a result, alternative monitoring approach including indebtedness could be less necessary to be employed as a control mechanism as suggested by free cash-flow theory since there is existence of strong monitor function by women directors.

Notwithstanding the aforementioned benefits of a gender-balanced board, the benefits of having woman director on board depends on the existence of "critical mass" situation (Konrad et al., 2008). In other words, there should be adequate number

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of female directors in board before their opinions can be genuinely noted and appreciated (Torchia, Calabrò, & Huse, 2011). Besides that, the culture of individual countries is also one of the determinant of the women ‘s performance (Terjesen & Singh, 2008).

Cost of Debt

Apart from that, cost of debt also associated negatively with information asymmetry problem. It is due to the external investors may perceive controlling shareholders are likely to expropriate them when the corporate transparency is low (Anderson, Duru, & Reeb, 2009; Fan & Wong, 2002; Leuz, Nanda, & Wysocki, 2003) especially in weaker institution environment (Dyck & Zingales, 2004; Porta, Lopez-de-silanes, Shleifer, & Vishny, 2000). The transparency problem went lower when the it can be overcome through reducing the agency cost (Bhojraj & Sengupta, 2003; Sengupta Partha, 1998) and increase the earning quality (Francis, LaFond, Olsson, & Schipper, 2005) by transparent disclosure especially in accounting and financial information (Bushman & Smith, 2001; Pittman & Fortin, 2004; Smith & Warner, 1979). In summary, cost of debt reduced when conflict of interest be alleviated through efficient debt contract when there is a transparent habit shod by the borrower (Armstrong, Guay, & Weber, 2010). It is even more pronounced in the country when the formal institution is weak whereas informal contracts which consist of relationship developed over years (Armstrong et al., 2010). On the other hand, cost of debt goes up when corporate opacity has taken place (Ma et al., 2017).

Women Directors and Cost of Debt

A gender-balanced board is one of the effective solutions to tackle with information asymmetry problem once again. It is because women directors possess higher ethical value than man. For example, they are less likely to be involved in bribery and corruption compared to their male peers (Swamy, Knack, Lee, & Azfar, 2001). Therefore, it should result in more transparency disclosure and higher earning quality (Wahid, 2018).

Conclusion

Women directors contributed to the BOD in various ways including strengthen monitor, promoted higher transparency in information disclosure, cultivated ethical value among the BOD. All of these contributions helped in alleviating agency cost which arise between shareholders and the management as well as leading to lower cost of debt as a result of debt providers' confidence been regained.

Nevertheless, there are limited empirical evidences on the relationship between women directors and cost of debt especially in emerging market including Malaysia. This constitute a research gap which need to be addressed as past studies suggested that outcome between developed and emerging market might not be the same due to number of institutional issues (Fan et al., 2011; Tee, 2018) which may lead to the organization and behaviour differences. On top of that, the study is also going to respond to the callings from past literatures to extend the cost of debt research in different context (Hashim & Amrah, 2016).

The implications of such study are as follows. Firstly, it contributes to the hot debates on how women directors contribute to the board since they play a significant role in terms of governance (Carter et al., 2010; Farrell & Hersch, 2005) and provide empirical evidence so it may serve as a basis or references for the future research.

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Secondly, it contributes to the further understanding of different context's outcome, specifically cost of debt between developed and emerging market.

Practically, it sheds light to the regulators and policy makers in setting future Corporate Governance guideline. For example, future guideline may emphasise the necessity of a gender-balance board to encourage more women to be on BOD for better firm performance and country's economy growth. Besides that, it also provides insight to nomination committee in recruiting new board member for the best interest of the firm. Lastly, it can become an additional reference to the potential investors when making their investment decision.

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