HOW COULD BOARD DIVERSITY INFLUENCE CORPORATE DISCLOSURE?

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Abstract

This paper aims to provide a theoretical analysis on the relationship between diversity and corporate disclosure. A literature review has been conducted to assess the aforementioned relationship. Through the literature, agency theory and stakeholder theory support board diversity. This paper explains how Hofsetde-Gray culture theory could be used to explain the relationship between nationality as one of the diversity characteristics, and corporate disclosure. Presence of a diverse board is expected to positively influence corporate disclosure. On one hand, this paper provides future research an opportunity to empirically assess this relationship. On the other hand, the positive influence that board diversity has on corporate disclosure provides an opportunity to companies to diversify their boards according to different nationalities and gender type.

Keywords: Disclosure, Board diversity, Agency theory, Stakeholder theory, Hofsetde, Gray, Culture

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1. Introduction

During the last couple of decades, diversity of managers and board members has been one of the most important corporate governance issues; thus, corporate disclosure. Kang et al. (2007, p. 195) define board diversity as the "variety in the composition of the board of directors". Diversity is divided into two categories: observable or demographic diversity and less visible/non-observable or cognitive diversity (Milliken and Martins, 1996; Erhardt et al., 2003). Observable diversity includes the following factors: nationality, age, gender, and race/ethnic background. Non-observable diversity comprises professional experience, educational background, and organisational membership (Erhardt et al., 2003; Kang et al., 2007).

Through the literature, several advantages of board diversity have been identified including enhanced board discussion, increased creativity and innovation, better problem solving, increased exchange of ideas, providing new insights and perspectives to the board, in addition to developing board's understanding of the market place (Watson et al., 1993; Siciliano, 1996; Coffey and Wang, 1998; Carter et al., 2003; Schippers et al., 2003; Knippenberg et al., 2004). Advantages of board diversity are derived from the perspective that board independence will be promoted since board members come from different backgrounds, culture, and nationalities. Moreover, gender diversity promotes different ways of thinking as discussed in the paper. Board independence will be witnessed through asking variety of questions - which will enhance the board discussion and all the above mentioned advantages- that would not have been asked if all board members have identical characteristics (Carter et al., 2003; Arfken et al., 2004). Enhancing board independence will increase corporate information disclosure. This perspective of board independence is derived from the agency theory, whereas another view of the importance of board diversity is derived from the stakeholder theory.

The agency theory predicts a positive relationship between board diversity and corporate disclosure since board diversity is expected to increase board independence (Carter et al., 2003; Arfken et al., 2004). However, in Terjesen et al. (2009), when classifying theories used to explain women on board, there was no disclosure characteristic identified. The agency theory was among the dominant perspectives used at the firm level, in addition to being used in relation to the performance characteristic.

According to the stakeholder theory, boards' functions extend to protect the interests of all involved stakeholders other than shareholders; accordingly, stakeholders' representatives shall be on board (Luoma and Goodstein, 1999; Huse and Rindova, 2001; Kang et al., 2007). Francoeur et al. (2008) support using the stakeholder theory rather than the agency theory with respect to board diversity. They argue that "many studies have confirmed the accuracy of stakeholder theory" (Francoeur et al., 2008, p. 85). According to the earlier discussion on the stakeholder theory, companies involving more women on board and senior management levels reflect protecting the interests' of various stakeholders; thus, a positive relationship is expected between women's presence on board and senior management and corporate disclosure. Thus, the stakeholder theory also supports a positive relationship between board diversity and disclosure.

Diversity characteristics that have been discussed in the current research are gender and nationality. Most of the research found through the literature uses the agency theory and the stakeholder theory to explain the importance of board diversity and how it influences firm's value, disclosure level, and firm's governance behaviour. This research paper addresses how Hofsetde-Gray's theory can also explain the relationship between board diversity and corporate disclosure. This paper can be considered the first to theoretically assess the relationship between diversity and corporate disclosure. Accordingly, the paper is divided into the following sections; Section 2 discusses Hofsetde-Gray theory, Section 3 addresses the gender characteristic, Section 4 presents the nationality characteristic; finally, Section 5 provides concluding remarks to the paper.

2. Hofstede-Gray theory

Culture has been identified as one of the important factors affecting disclosure practices. Hofstede-Gray theory has been extensively used through the accounting literature to explain the cultural impact on financial reporting as well as on corporate disclosure. Hofstede (1984) identified four value dimensions representing the common structure elements in countries' cultural systems. Gray (1988) has linked Hofstede's societal value dimensions to the development of accounting systems deriving four accounting values.

2.1 Importance of culture with respect to disclosure

Through the literature culture has had various definitions that allowed Kroeber and Kluckholn (1952 cited in Haniffa and Cooke, 2002) to identify 164 definitions. However, the current research is based on two definitions. The first definition is for Hofstede (1984), who defines culture as "the collective programming of the mind which distinguishes the members of one group or society from those of another" (Hofstede, 1984, p. 82). The second is for Harris (1987 cited in Haniffa and Cooke, 2002), who defines culture as "the learned, socially acquired traditions and life styles of the members of a society, included their patterned, repetitious way of thinking, feeling and acting" (Haniffa and Cooke, 2002, p. 323).

The importance of culture as a factor affecting disclosure has been identified by Belkaoui (1983). Haniffa and Cooke (2002, p. 318) justify this importance to be as follows: "because the traditions of a nation are instilled in its people and might help explain why things are as they are." Moreover, a society's culture and environment shape its accounting system (Perera, 1989; Belkaoui and Picur, 1991; Fechner and Kilgore, 1994). Thus, culture can clarify reasons beyond a certain disclosure style in a country. Another reason for the importance of assessing culture when studying disclosure is that companies disclose information that replicates their compliance with regulations and prevailing norms representing the social values (Gibbins et al., 1990).

Hofstede-Gray theory has been extensively used through the accounting literature to explain the cultural impact on financial reporting as well as on disclosure (e.g., Baydoun and Willett, 1995; Saudagaran and Meek, 1997; Williams, 1999; Dahawy et al., 2002).

2.2 Hofstede's model

Hofstede (1984) identified four value dimensions representing the common structure elements in countries' cultural systems: individualism versus collectivism, large versus small power distance, strong versus weak uncertainty avoidance, and masculinity versus femininity. The first dimension, individualism versus collectivism, describes the interdependence degree among individuals of one society. Individualism describes a society where individuals have very loose ties, being independent of other people than themselves and their families. On the other hand, collectivism describes a society where individuals' binds are very tight enjoying unquestioning loyalty.

Power distance reflects members' acceptance to unequally distributed power among people. Hierarchical orders are accepted in societies where large power distance prevails with no keen on its justification, on the contrary to societies where individuals struggle for reasons beyond inequalities and seek achieving equalisation (Hofstede, 1984).

Uncertainty avoidance represents the attitude of society's members towards ambiguity and uncertainty, especially regarding the future. Societies, where weak uncertainty avoidance exists, accept deviant persons, ideas, and the unforeseen future, while strong uncertainty avoidance societies try to control the outcomes of the future and deny deviant persons and ideas where they maintain rigid beliefs and behaviours (Hofstede, 1984).

The final dimension, masculinity versus femininity, portrays society's way in allocating social roles based on the gender type (Hofstede, 1984). Masculinity reflects societies where preference for heroism, achievement, assertiveness, and material success exists. In other words, those societies have clearly different gender social roles. On the contrary, femininity represents those societies that prefer relationships, quality of life, and modesty and caring for the weak; then, they are those societies where social genders overlap (Hofstede, 1984).

2.3 Gray's model

Gray (1988) has linked Hofstede's societal value dimensions to the development of accounting systems deriving four accounting values: professionalism versus statutory control, uniformity versus flexibility, conservatism versus optimism, and secrecy versus transparency. Professionalism describes the preference for practicing individual professional judgment and self regulation, accordingly, enjoying independent attitude. Statutory control portrays being obliged to comply with legal regulations. Uniformity represents a status where accounting practices in all companies are identical according to the imposed regulations; on the other hand, flexibility reflects the contrast status, where each company's practices depend on its own circumstances.

Conservatism expresses the status of being cautious in measurement, reflecting the uncertainty avoidance attitude towards future issues, while optimism represents the risk-taking approach. Secrecy describes the preference for confidentiality, which impacts information disclosure and lets it be restricted to those involved in management and financing issues of a business. On the other hand, transparency reflects the preference for the open approach that is accountable to the public (Gray, 1988).

2.4 Hofstede-Gray relationship

Table 1 clarifies the relationship between societal values (Hofstede's model, 1984), accounting values (Gray's model, 1988), and accounting practices including disclosure that has been determined by Radebaugh and Gray (2006) when addressing international accounting.

Table 1. Relationship between societal and accounting values, and accounting practices

Societal Values →	Accounting Values →	Accounting Practice
Individualism/Collectivism Power distance Uncertainty avoidance Masculinity/Femininity	Professionalism Uniformity/Flexibility Conservatism/Optimism Secrecy/Transparency	Authority and enforcement Measurement of assets and profits Information disclosures

Source: Radebaugh and Gray (2006, p. 50)

The detailed impact of each of Hofstede's cultural dimensions on Gray's accounting dimensions has been clarified by Baydoun and Willett (1995) as shown in Table 2.

Table 2. Relationship between Gray's accounting dimensions and Hofstede's cultural dimensions

Accounting values (Gray) / **Cultural values (Hofstede)**	Professionalism	Uniformity	Conservatism	Secrecy
Power distance (*large*)	-	+	?	+
Uncertainty avoidance (*strong*)	-	+	+	+
Individualism	+	-	-	-
Masculinity	?	?	-	-

Note: '+' indicates a direct relationship between the relevant variables; '-' indicates an inverse relationship. Question marks indicate that the nature of the relationship is indeterminate.
Source: Baydoun and Willett (1995, p. 71)

Gray has argued that societies with high uncertainty avoidance, large power distance, preference for collectivism, and enjoying a feminine attitude tend to be secretive, affecting information disclosure practices where low information disclosure occurs (Gray, 1988; Gray and Vint, 1995; Chau and Gray, 2002; Archambault and Archambault, 2003). Salter and Niswander (1995) find that secrecy is associated with uncertainty avoidance and individualism, whereas power distance and masculinity were not significantly related to secrecy. Another study by Zarzeski (1996) found that disclosure was positively associated with individualism, power distance, and masculinity, but negatively associated with uncertainty avoidance.

For example, Arab countries are characterised by strong uncertainty avoidance, collectivism, large power distance, and masculinity in terms of Hofstede's model (Hofstede, 1991). On the other hand, Arab countries 'Near Eastern' are classified as societies with statutory control, uniformity, secrecy and conservatism with respect to Gray's model (Gray, 1988). Therefore, it can be said that in the Arab Near Eastern countries, a negative relationship is found between masculinity and disclosure. In other words, secrecy exists where masculinity prevails in those countries. This was supported by research on corporate social disclosure where Van der Laan Smith et al. (2005) and Orij (2010) found a negative relationship between masculinity and disclosure.

Finally, it shall be noted that Hofstede theory has been criticised by many authors (e.g., Baskerville, 2003) as its origin was surveying IBM employees in 50 countries and three multi country regions, and employees who filled in the survey questionnaires held similar positions. Then, Hofstede grouped the world into 7 regions: Anglo, Nordic, Germanic, more developed Latin, less developed Latin, Asian, and Near Eastern that includes Arab countries. Even though the Hofstede-Gray theory might lack precision in terms of financial reporting (Haniffa and Cooke, 2002), it has been extensively used through the accounting literature (e.g., Baydoun and Willett, 1995; Saudagaran and Meek, 1997; Williams, 1999; Dahawy et al., 2002). Moreover, Salter and Niswander (1995) find that Gray's model has statistically significant explanatory power in terms of explaining financial reporting.

In addition, all the previous discussion on the importance of cultural impact on disclosure using Hofstede-Gray theory supports its explanation of the relationship between the nationality and corporate disclosure. Similar to the previous example, being an Arab 'a non-foreigner' means coming from a culture that prefers secrecy, in other words preferring to disclose less information (Gray, 1988; Niswander and Salter, 1995; Zarzeski, 1996).

3. Gender

Brennan and McCafferty (1997) and Fondas (2000) identified the reasons that presence of women on board leads to increasing firms' values. First, women are more independent as they are not part of the "old boys" network, thus can increase the firm's value. Second, women might provide more insights about the companies' opportunities in meeting their customers' needs, since they might better understand customers' behaviours and needs. Bernardi et al. (2002) support the view that presence of women on board will improve board's monitoring (Carter et al., 2003), thus enhancing corporate governance which can lead to increasing the competitive advantage for companies (Bernardi et al., 2002).

Burgess and Tharenou (2002, p. 40) and Carter et al. (2003, p. 36) summarised the advantages of having women on board as follows: increased diversity of opinions in the boardroom, bringing strategic input to the board, influence on decision making and leadership styles of the organization, providing female role models and mentors, improving company image with stakeholder groups, women's capabilities and availability for director positions, insufficient competent male directors, and ensuring "better" boardroom behaviour. Another aspect identified by Nielsen and Huse (2010) is that women on board can reduce the level of conflict and ensure high quality of board development activities.

To conclude advantages of gender diversity, Francoeur et al. (2008, p. 85) argue that:
"it seems that, in today's complex and rapidly changing business environment, when it comes to enhancing the quality of decision making, the advantages related to the knowledge, perspective, creativity, and judgment brought forward by heterogeneous groups may be superior to those related to the smoother communication and coordination associated with less diverse sets of people.

Shrader et al. (1997) find a positive relationship between women in management positions and companies' financial performance. Burke (2000) also finds that presence of women on board is positively related to companies' profitability. Ripley et al. (2003 cited in Kang et al., 2007) reveal a positive relationship between presence of women on board and company's earnings and shareholder's wealth. Carter et al. (2003) and Erhardt (2003) find a positive association between the percentage of women on board and firm value. Adams and Ferreira (2004) also support the view that increasing the percentage of women on board will enhance the board's successfulness as they will raise issues at board meetings that would not have been raised in homogenous boards. Similarly, Huse and Solberg (2006) support the same view that women directors will enhance board's decision making.

Francoeur et al. (2008) reported a positive relationship between the proportion of women in senior management levels and abnormal returns in complex environments but no significant relationship concerning women on board. Nielsen and Huse (2010) also find a positive relationship between women on board and the board's strategic control. Carter et al. (2010) find no significant association between gender type and firm performance. Finally, Gul et al. (2011) find a positive relationship between gender diversity and stock price informativeness.

The relationship between the presence of women on board and corporate disclosure could be through the agency theory and the stakeholder theory. It is important to note that the agency theory has been criticised with respect to the relationship between board diversity and firm value by Francoeur et al. (2008, p. 85):
"From an agency-theoretic standpoint, when one considers the overall impact of gender diversity on the various duties being assumed by a corporate board, it is thus impossible to tell, whether promoting greater female participation will improve or impair corporate governance and, as a direct consequence, corporate financial performance."
However, Francoeur et al. (2008) supported using the stakeholder theory rather than the agency theory. They argued that "many studies have confirmed the accuracy of stakeholder theory" (Francoeur et al., 2008, p. 85).

Carter et al. (2003) used the agency theory to explain the relationship between presence of women on board and firm value. Gul et al. (2011, p. 315) assure that "Gender-diverse boards improve the quality of public disclosure through better monitoring." Based on the agency theory, since presence of women on board increases board independence as discussed earlier, therefore, a positive relationship between presence of women on board and corporate disclosure is expected. Accordingly, both of the agency theory and the stakeholder theory predict a positive association between presence of women on board and corporate disclosure.

4. Nationality

Li and Harrison (2008) support the view that national culture has a major impact on corporate governance. Nationality has become on one of the important diversity characteristics (Ruigrok et al., 2007). As discussed earlier that diversity enhances board's independence and effectiveness, another view by Milliken and Martins (1996) is that diversity can lead to negative effects and outcomes. However, Ruigrok et al. (2007) argue that the board's effectiveness will increase as a result of presence of foreigners on board. They justified that the benefits will outweigh the negative effects when different values, norms, and understanding will be set, making use of the different perspectives, values, and knowledge provided by directors of different nationalities (Ruigrok et al., 2007). The same argument was supported by Masulis et al. (2010 cited in Brickley and Zimmerman, 2010): "Despite their monitoring deficiencies, foreign independent directors may enhance the advisory capability of boards" (Brickley and Zimmerman, 2010, p. 237).

Erhardt et al. (2003) find a positive association between the non-white women on board and companies' financial performance as they included both gender and ethnicity as one measure of diversity. Carter et al. (2003) find a positive association between the ethnic minority board members and firm value. Ayuso and Argandona (2007) and Khan (2010) find that foreigners on board support corporate social responsibility reporting. Finally, on the other hand, Carter et al. (2010) find no significant association between ethnicity and firm performance.

Since nationality resembles culture, Hofstede-Gray theory can also be used to explain the nationality variables, in addition to the agency theory discussed earlier. It should be noted that Haniffa and Cooke (2002) is the only study that assessed the impact of cultural variables on voluntary disclosure. They test race and education as cultural (diversity) factors in the Malaysian environment. Two ethnic groups are spread in Malaysia: Malays and Chinese. Race has been assessed through the relationship between disclosure and each of the following five variables: race of the managing director, finance director, chairperson, proportion of Malay directors on board, and proportion of Malay shareholdings. Although Haniffa and Cooke (2002) accepted the difficulty and lack of precision of the Hofstede-Gray theory, they have used it as being "the best at explaining actual financial reporting practices" (Salter and Niswander, 1995, p. 379).

Based on the above discussion, since board diversity is expected to increase board independence (Carter et al., 2003; Arfken et al., 2004), a positive relationship is expected between diversity and corporate disclosure. Accordingly, the agency and Hofstede-Gray theory can also explain the nationality variables.

5. Concluding remarks

This paper is considered the first to theoretically assess the relationship between diversity and corporate disclosure. The paper aimed to provide a theoretical analysis on the relationship between diversity and corporate disclosure through the agency theory and the stakeholder theory which are the most common theories found through the literature. Several advantages of board diversity have been identified that enhance board independence; thus a positive relationship is expected between board diversity and corporate disclosure. Moreover, representatives of all stakeholders should be present on board to protect the interests of all involved stakeholders. Accordingly, a positive relationship is expected between diversity and corporate disclosure. In addition, an explanation of how Hofsetde-Gray culture theory could be used to assess the relationship between nationality as one of the diversity characteristics and corporate disclosure was provided. The paper contributes to the literature of board diversity as well as to the literature of corporate disclosure. Accordingly, this provides future research the theoretical basis of empirically assessing the aforementioned relationship. The positive influence that board diversity has on corporate disclosure provides practitioners an opportunity to diversify their boards according to different nationalities and gender type.

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