

BOARD'S IMPACT ON THE FIRM'S STRATEGIC CHANGE

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Received: 12th July 2023

Accepted: 20th September 2023

ABSTRACT

We investigate whether board attributes affect strategic change of Malaysian listed companies from 2013 to 2020. Our findings indicate that board independence, board tenure, board ethnicity and multiple directorships significantly influenced strategic change. This study underscores the importance of board diversity and directors' commitment to strategic change, providing valuable insights for companies seeking performance improvement. The MCCG 2021 emphasizes the significance of implementing best practices for board structure, and our research suggests that board attributes play a vital role in a company's ability to respond and adapt to a dynamic business environment, essential for growth and survival in a competitive market.

Keywords: Board independent, board tenure, board size, board age, strategic change.

1.0 INTRODUCTION

In today's world, businesses are facing more complexity due to globalization, technology, and how society behaves. Traditional methods are inadequate for success, necessitating the exploration of new strategies considering internal and external conditions (Mintzberg & Lampel, 1999). Malaysia's recent decline in private equity and mergers and acquisitions, along with a slow increase in the globalization index, highlights the need to investigate strategic change in the country. Strategic change is crucial in today's dynamic business environment to remain competitive (Choi et al., 2021; Triana et al., 2019). Boards of directors are vital in leading and supervising these changes. They set the company's direction and make sure it adjusts to market shifts, technology, and customer needs. They do more than oversee – they make smart choices that drive growth and lasting success. So, their role in planning and implementing strategic changes is crucial. During strategic changes, boards of directors face significant challenges. One challenge is resistance, where members may hesitate due to uncertainty and depart from familiar strategies which can slow adaptation to new approaches (Samara & Yousef, 2023). Diversity in backgrounds and skills is helpful but can create gaps in crucial expertise for understanding changes. This gap might slow decision-making and risk identification (Zaharudin & Jalil, 2022). Groupthink, where everyone agrees, hampers new ideas while disagreements also hinder decisions about big changes. Effective oversight by the board is crucial for successful changes. Without it, actions might stray, endangering outcomes.

This study seeks to explore the impact of a company's board of directors' composition on the success of strategic change efforts. There is currently a dearth of existing research on this topic. Specifically, it seeks to explore the extent to which board independence, tenure, age, multiple directorships, educational background and ethnicity among board members affect the strategic change efforts in corporations. The paper is organized as follows: Firstly, we review the literature and propose hypotheses to test the relationship between board attributes and strategic change.

Secondly, we describe our methodologies and present the results. Finally, we discuss the paper's implications and limitations in the conclusion.

2.0 LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

2.1 Theories

Agency theory examines the dynamics between owners (shareholders) and managers (including the board) in organizations, focusing on how conflicts between them influence decisions and performance (Kasbar et al., 2023; Maznorbalia et al., 2023). The theory underscores the significant information asymmetry that exists, where shareholders possess less understanding of operations compared to the better-informed board and management (Sun et al., 2023). This knowledge gap impacts the board's assessment and supervision of planned strategic changes (Fama & Jensen, 1983). Within agency theory, this role becomes crucial, as boards must diligently ensure that management's choices align with shareholders' interests and are free from personal biases. Effective governance hinges on aligning shareholders' and management's interests, a concept tightly linked to board composition. The variety of skills and experiences on the board acts as a catalyst, empowering directors to understand the nuances of strategic changes and advocate for shareholders (Saad, 2022). Transparent decision-making and effective communication are vital for minimizing conflicts between principals and agents. The board's composition shapes transparency and accountability mechanisms, influencing how strategic changes are communicated and justified to shareholders. Agency theory emphasizes that agency costs, stemming from potential conflicts between principals and agents, significantly impact a company's performance. The composition of the board directly influences these costs, potentially shaping the effectiveness and success of strategic change endeavours (Ben & Padilla, 2019). Resource Dependence theory (RDT) emphasizes directors' strategic roles in linking the firm with external resources (Masud et al., 2019). According to RDT, organizations aim to minimize their dependency on external resources by establishing control mechanisms. Boards play a key role in this by guiding strategic changes that might lead to the acquisition of new resources or a reduction in dependence on existing ones. Their decisions can determine whether the organization seeks new partnerships, diversifies revenue streams, or accesses novel capabilities.

2.2 Strategic change

In today's competitive environment, taking risks and making bold strategic moves are crucial for firm development and survival (Wang et al., 2018). Hence, keeping up with the ever-changing business environment requires strategic change (Sidhu et al., 2021), which is vital for competitive advantage and goal achievement (Hsu et al., 2019). Board attributes, such as skills, experience, knowledge, and networking relationships, are related to strategic change (Perez-encinas et al., 2021), suggesting that their roles have evolved from oversight and advice to active participation in strategic decision-making (Langan et al., 2022).

This study focuses on the resource allocation type of strategic change, using the Strategic Resource Allocation Profile (SRAP) model developed by (Mintzberg, 1978; Finkelstein & Hambrick, 1990). SRAP measures six elements of financial indicators within the company, namely advertising intensity, R&D intensity, plant and equipment renewal, non-production overhead, inventory levels, and financial leverage. Following Díaz-Fernández et al. (2019), for each indicator, the difference between the current year and the previous year is computed and adjusted using industry medians. The resulting industry-adjusted differences are transformed into absolute values and standardized. The extent of strategic change (SC) is then determined by calculating the mean of these standardized values. Strategic Change is calculated as $[(\text{advertising}/\text{sales}) + (\text{R\&D}/\text{sales}) + (\text{new plant and equipment}/\text{gross plant and equipment}) + (\text{SGA expenses}/\text{sales}) + (\text{inventory}/\text{sales}) + (\text{debt}/\text{equity})]$ at time t and year $t-1$.

2.3 Board of Directors attributes

We examined six board attributes in our study, which are as follows:

Board independence: Independent directors play a crucial role in promoting strategic change within a company. Their independence from the management and ownership of the company allows them to provide unbiased and objective insights, contributing to more informed decision-making and effective strategic change implementation. The board of directors is responsible for monitoring management, establishing corporate policies, and approving the firm's strategic plan (Mirone et al., 2021; Rebeiz, 2018), and independent directors address opportunistic practices, enhance efficacy in curtailing earnings manipulation, and result in a more watchful board that actively works towards minimizing excess cash reserves (Cambrea et al., 2021; Saona et al., 2020). Existing evidence shows that independent directors are a strong governance tool as they are associated with higher performance, improve protection of shareholders' interest and effective in the adoption of CSR policy (Mirone et al., 2021), and increase investment efficiency and innovation (C. Y. Hsu et al., 2021; Li et al., 2022; Mirza et al., 2020). We posit that,

H1: A higher proportion of independent directors on the board is positively related to strategic change.

Board tenure: Vafeas (2003) introduced two concepts, management friendliness and expertise concerning long board tenure. Recent studies support the expertise view of longer tenure as they are effective in reducing leverage, improving transparency, and increasing financial performance (James et al., 2021; Tahir et al., 2020; Tejerina-Gaite & Fernández-Temprano, 2021). Livnat et al. (2019) stated that longer tenure allows directors to identify unique opportunities and design better policies, thus limiting managers' opportunistic behaviour. Directors with longer tenure also excel in problem-solving, information processing, decision-making, and risk mitigation (Bhat et al., 2020). They also have a better understanding of the firm's activities, economic environment, and financial reports (Fernández-Temprano & Tejerina-Gaite, 2020). As directors gain more experience over an extended period, it is commonly believed that they acquire a notable capacity to actively participate in driving strategic changes (Lungeanu & Zajac, 2019).

Despite the advantage of accumulated expertise, some studies showed that longer tenure is associated with lower financial performance and has caused mispricing of shares (Livnat et al., 2021). Longer tenure is also associated with weak monitoring and board entrenchment (Ji et al., 2021), lower disclosure on corporate social responsibility (Ratri et al., 2021), lower investment efficiency (Tran Phuong et al., 2022), lower R&D investment (Azzam & Alhababsah, 2022) and lower financial leverage (Bazhair, 2023; Tahir et al., 2023). Consistent with the management-friendly view, it is anticipated that extended tenures could compromise the board's ability to effectively oversee and contribute to strategic initiatives. We posit that prolonged tenure might not be conducive to driving significant strategic changes within the organization.

H2: Longer board tenure is negatively related to strategic change.

Board age diversity: Young directors may bring new perspectives and diverse backgrounds that foster innovation and creativity despite their lack of experience (Abu Qa'dan & Suwaidan, 2019; Lamichhane, 2021), but older directors having experience and expertise, they may contribute to elevated levels of financial performance (Fernández-Temprano & Tejerina-Gaite, 2020; C. S. Hsu et al., 2019). There is mixed evidence on whether age diversity is beneficial to firms. Some evidence showed that age diversity does not improve corporate social responsibility practice, strategic change, and dividend policy (Prudêncio et al., 2021; Tahir et al., 2020) while others found it increased strategic change frequency, reduced corporate risk, improved social performance, lower the risk of future stock crashes (Bhat et al., 2020; Jebran et al., 2020), enhance the positive relationship between corporate social responsibility and firms' performance, and enhance the U-shaped relationship between government subsidy and corporate green innovation (Ozdemir et al., 2021; Wu et al., 2019; Xia et al., 2022). The relationship between age diversity and strategic change within firms is nuanced and multifaceted. While both positive and negative effects of age diversity may exist within the context of strategic change, the focus on the positive effects is justified due to the potential benefits it offers. Age-diverse teams can lead successful strategic changes by utilizing

multigenerational knowledge, creative problem-solving, balanced decisions (Perez-encinas et al., 2021), complementary skills, better problem identification, and fostering a lasting organizational culture, promoting long-term growth and success (Zaharudin & Jalil, 2022; Zoellner & Sulikova, 2021). We posit that,

H3: Diverse board age is positively associated with strategic change.

Board ethnicity: The composition of a company's board of directors has gained significance as a potential driver of strategic decision-making and organizational transformation. Exploring the dynamic interplay between board ethnicity and the process of strategic change, delving into how the ethnic diversity of a board can influence the formulation, implementation, and outcomes of strategic initiatives. Waweru (2018) found that diverse boards are associated with lower earnings management. Diverse boards positively affect strategy design (Tee & Rassiah, 2020), and enhance the effect of goodwill impairment decisions on market capitalization (Abdul-Majid, 2020; Attia et al., 2021). Quintana-Garcia et al.(2022) found that having a mix of ethnicities in management positions strongly correlated with better innovation abilities.

In contrast, Madni (2019) observed that ethnic diversity in Pakistan weakens institutions and affects economic growth. Ethnic diversity leads to delayed goodwill write-offs (Abdul-Majid, 2020), and ethnic diversity within a local area has a detrimental effect on investment efficiency. This is because such diversity is linked to reduced levels of social trust, a crucial factor in making investment decisions (Zou et al., 2021). Based on the literature, while ethnic diversity increases, the social fabric could potentially weaken, leading to challenges in fostering trust and collaboration among diverse individuals. This, in turn, could harm the overall effectiveness of decision-making processes and potentially hinder the achievement of common goals. Cheong's (2022) findings of a curvilinear relationship between ethnic diversity and firm performance affirmed that diversity's influence may be positive initially but decline over time. We posit that,

H4: Diverse ethnicity on board is negatively related to strategic change.

Board education: Formal education in fields like business administration, strategic management, or related disciplines allows directors to develop a deep understanding of how businesses operate, the complexities of various industries, and the factors that drive success in a dynamic market landscape. Education equips directors with the knowledge, tools, and frameworks to engage in strategic thinking (Lin et al., 2022). It can be done by shaping their strategic thinking, informed decision-making, industry knowledge, change management skills, adaptability, global perspective, risk assessment, ethical considerations, communication abilities, and long-term vision (Zaharudin & Jalil, 2022). A well-educated director brings advanced insights into complex business environments, effectively manages change-related challenges, considers industry-specific nuances, and fosters innovation (Leung & Sane, 2023), ultimately guiding the organization through successful strategic transformations.

Incorporating diverse educational backgrounds into the board of directors fosters creativity, innovation, and effective problem-solving. Educational diversity brings varied perspectives, talents, and experiences, challenging conventional thinking and leading to well-informed decisions. Studies have shown that boards with varying education levels enhance corporate social disclosure, boost competitive advantage, and provide diverse knowledge and information-processing behaviours for better assessment of environmental changes and strategic options (Azam et al., 2019; Katmon et al., 2019). We posit that,

H5: Diverse education level is positively associated with strategic change.

Multiple directorships: Holding multiple directorships can make directors experts by bringing insights from various firms. On the other hand, some argue that being overly busy can result in reduced focus and limited participation in meetings. While multiple directorships may provide access to diverse ideas and experiences, recent evidence indicates potential harm to a firm's performance. Multiple directorships can lead to conflicts of interest as directors prioritize one board's interests over others.

Limited time and energy may result in reduced involvement and dedication, leading to ineffectiveness and losses in companies (Latif et al., 2020; Lusiana et al., 2020). This practice may expose firms to higher earnings management practices and delay recognition of loan loss provisions (Kutubi et al., 2021). Reducing multiple directorships can improve firms' operating performance, monitoring, and strategic advising (Brown et al., 2019) and avoid negative abnormal returns and underinvestment (Park, 2019). However, multi-board directors in firms with higher agency problems may make better cash acquisitions (Chou & Feng, 2019). We posit that,

H6: Multiple directorships are negatively associated with strategic change.

3.0 METHOD

3.1 Data and sample

Our research examined a total of 736 non-financial firms listed on the main board of Bursa Malaysia. The study period extends from 2013 to 2020, and a separate investigation might be necessary to analyse post-2020 data. This would allow for a comprehensive understanding of the shifting behaviours and characteristics of boards, potentially influenced by the implementation of MCCG 2021. We excluded finance-related firms due to their distinct characteristics and regulatory requirements (Islam et al., 2020). The sample included companies from nine sectors: industrial products (240), consumer (173), property (99), trading and services (80), construction (51), plantation (41), technology (31), REIT (17) and IPC (4). Data on strategic changes and board attributes were collected from the Bloomberg database and annual reports of the companies. We include firm size (FS) and board size (BS) as control variables because they influence strategic decisions (Cucari et al., 2018; Singh et al., 2018).

3.2 Regression model

The following regression model is used to test Hypotheses 1 to 6.

$$SC_{it} = \alpha + \beta_1 BID_{it} + \beta_2 BT_{it} + \beta_3 BA_{it} + \beta_4 BE_{it} + \beta_5 BEd_{it} + \beta_6 Md_{it} + \beta_7 FS_{it} + \beta_8 BS_{it} + \varepsilon_{it} \quad (1)$$

where:

For each firm (i) and each year (t),

- SC_{it} = [(advertising/sales) + (R&D/sales) + (new plant and equipment/gross plant and equipment) + (SGA expenses/sales) + (inventory/sales) + (debt/equity)] t and year t-1;
- BID_{it} = The proportion of independent members to the board's total members
- BT_{it} = The average number of years the hat board directors has served in a firm in the year t
- BA_{it} = The standard deviation of the ages of the board members in each sample company divided by the mean
- BE_{it} = The proportion of Bumiputera directors to total directors on the board
- BEd_{it} = Blau's Index data on the proportion of board of directors in each category of educational level (Ph.D., master's degree, undergraduate degree, diploma, and others)
- Md_{it} = The proportion of directors on the board who hold directorships in other listed companies
- FS = Natural logarithm of total assets
- BS_{it} = Total number of directors on the board of the company;
- ε_{it} = error term

$$BI = 1 - \sum_{i=1}^n P_i^2 \quad (2)$$

Blau's Herfindahl Index used to measure BEd_{it}, a widely used index for measuring heterogeneity,

where,

- BI = Blau's Index;
- P = The proportion of board members in each category of educational level;
- i = represents category;
- n = Total number of board members in each category.

4.0 RESULTS AND DISCUSSIONS

4.1 Descriptive statistics

Table 1 summarizes statistics for SC and board characteristics, with continuous variables bounded by the 1st and 99th percentiles. The average relative strategic change score is 12%, compared to -59% (Kalasin, 2021) and -9% (Back et al., 2020). The standard deviation of 1.11 indicates significant variation in strategic change implementation among sample companies. Some companies have fewer than the required 50% independent directors (min. BIND value: 0.25, Malaysian Code on Corporate Governance). Director tenures vary (0.5 to 24 years), while board age diversity and education levels are low (mean values: 0.18 and 0.30). On average, 30% of directors hold multiple positions. The largest sample board has 16 directors.

Table 1. Descriptive statistics

Variables	Obs	Mean	Med	Std. Dev	Min	Max
SC	4963	-0.004	-0.042	-0.05	-0.12	18.33
BIND	4963	0.49	0.50	0.13	0.14	1.00
BT	4963	9.02	8.38	4.7	0.69	28.58
BA	4963	0.18	0.17	0.06	0.01	0.49
BE	4963	0.30	0.25	0.27	0	1.00
BEd	4963	0.59	0.54	0.16	0	0.8
Md	4963	0.52	0.50	0.27	0	1.00
FS (million)	4963	RM 6.31	RM 6.17	RM 1.57	RM 6.21	RM 12.11
BS	4963	6.83	7.00	2.76	0.00	16.00

SC=Strategic change; BIND= Board independence; BT= Board tenure; BA= Board age; BE= Board ethnicity; BEd= Board education level; Md= Multiple directorships; FS= Total asset (firm size); BS= Board size.

4.2 Empirical result

Table 2 displays the outcomes of the board attributes' impact on strategic change. BIND, BT, and Md variables show significance at the 1% level, while BE is significant at the 5% level. These results validate hypotheses 1, 2, and 4, showing that more independent directors lead to increased strategic change. In contrast, longer tenures and diverse ethnic compositions result in reduced strategic change. Findings disprove hypothesis 6, indicating multiple directorships do not lower strategic change. Conversely, directors with multiple roles, drive higher strategic change. Neither BA nor BEd influences strategic change.

Our findings indicate that independent directors, who serve as vigilant monitors in organizations, have a crucial role in both overseeing and instigating strategic change. These directors contribute an external viewpoint and diverse expertise, allowing them to evaluate organizational performance

impartially. This observation aligns with prior research findings (C. Y. Hsu et al., 2021; Li et al., 2022; Mirone et al., 2021; Mirza et al., 2020; Rajkovic, 2020) that their oversight guarantees the allocation of necessary resources.

Table 2 Multiple Regression Results

Variable	Coefficient	t-value
Constant	-0.0815	-1.69
BIND	0.1531	2.78***
BA	-0.1686	-1.62
BT	-0.0042	-2.96***
BE	-0.0859	-2.23**
BE _d	0.0327	1.42
M _d	0.0511	2.82***
FS	-0.0060	-2.25**
BS	0.0122	2.05**

Notes: *p<0.10, **p<0.05, ***p<0.01

Consistent with Livnat et al. (2021), Tran Phuong et al. (2022), Azzam and Alhababsah (2022) and Bazhair (2023), we find that longer tenure is associated with less strategic change, supporting the management friendliness perspective. Directors with extended tenures may become aligned with management's ideas, focusing on stability over challenges of change. This friendliness might hinder their objective evaluation of change necessity. Longer-tenured directors know the company's history well, which could lead to resistance to altering established procedures. The negative effect of ethnic diversity is consistent with Abdul-Majid (2020), Zou et al. (2021) and Cheong (2022), on the downside of ethnic diversity. This adverse effect could be due to other factors such as cultural misalignment and trust issues which lead to communication problems, making strategic change less effective. Ramasamy and Yeung (2016) suggest that firms should emphasize promoting diversity based on values rather than exclusively focusing on ethnic diversity. It's important to distinguish between ethnic diversity and diversity of values. While the former has a detrimental impact on innovation, the latter has a beneficial effect on it. Our results differ from Brown et al. (2019), Park (2019) and Kutubi et al. (2021) who argued that multiple directors might become occupied overseeing businesses. Instead, our findings indicate that the accumulation of knowledge and experience is advantageous, contributing positively to such changes. Our findings align with the expert perspective as their extensive outlook and experience position them as change drivers, bringing vigour to organizations to excel in evolving business environments. The effects of board attribute BA and BE_d were determined to be insignificant. This could be attributed to a relatively milder impact, possibly stemming from the absence of other interplays of skills or leadership capabilities. The combined influence of board diversity, which interacts with age and education, contributes to the degree to which these attributes affect strategic change in organizations. FS and BS displayed statistical significance at a 5% level. This suggests that those attributes significantly influence the extent of strategic change within a company.

5.0 CONCLUSIONS

This study extends the conventional role of board fiduciary duty to explore the board attributes and their impact on strategic change. We investigate the influence of board attributes on strategic change. Results reveal positive links between board independence, multiple directorships, and increased strategic change. Conversely, longer tenures and diverse ethnic compositions are associated with lower strategic change, while board age and education show no significance. Independent directors are not just monitors but also drivers of change, enhancing initiatives,

decision-making, and countering biases. They promote transparency, accountability, and governance, ensuring sound implementation of strategic changes for long-term value.

Our findings prompt re-evaluation of longer director tenures and ethnic diversity. Addressing these is vital for effective strategic change efforts. As age and education diversity lack clear advantages, strategies should leverage their benefits while tackling challenges. Future research may look into how strategic integration, training, and cultural transformation can make age and education diversity drivers of successful strategic change. Our research illuminates how board composition influences strategic change, deepening our grasp of governance dynamics. These insights guide governance practices, with implications for succession planning, diversity initiatives, and regulatory frameworks, aiding industries in transformation. Our study informs how board attributes impact strategic change across sectors, noting it's limited to six attributes and predates MCGG 2021 changes.

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