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Diversity in human and social capital: Empirical evidence from Asian tourism firms in corporate board composition

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HIGHLIGHTS

- We test the effect of diversity in board's human and social capital on firm performance.
- Our sample comprises of 85 tourism firms from four Asian economies.
- Diversity in board's social capital has positive influence on firm performance.
- Diversity in board's human capital has negative influence on firm performance.
- The effects of the board diversity is significantly moderated in a crisis period.

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ABSTRACT

This study examines the links between the composition of the board of directors of 85 tourism firms in China, Hong Kong, Malaysia and Singapore and firm performance for the period 2001 to 2012. Distinctions are made between the composition of board's human and social capital, and it is generally found that diversity in board's social capital is positively related with firm performance, especially during periods of crisis. Nonlinearities are found in the relationship between diversification of board and firm performance, suggesting that an over-diversification of the composition of human and social capital can impede firm performance. Various recommendations are made based upon the findings.

1. Introduction

Board structure has become an important subject of investigation in academic research. Previous studies in corporate finance have tended to emphasize the board structure from the perspective of the composition of the independent and non-independent directors on a board. However, until the recognition of the role of the board of directors in reviewing and supervising the firms' strategic planning and implementation in studies such as Lorsch and Maclver (1989), Demb and Neubauer (1992) and Bordean, Borza, and Maier (2011), the research on the composition of the human and social capital of the directors on the board of a firm has been paid attention. The shift of research focus can be seen in recent studies such as Carpenter and Westphal (2001), Wincent, Anokhin, and Ortqvist (2010) and Kim and Lim (2010), which focus on an in-depth investigation of the human capital as well as social capital of the board of directors.

In practice, it should not be difficult to recruit a sufficient number of directors to the board who possess different backgrounds of expertise and social networks. However, there is research on the issue of whether greater diversity in human capital and social capital of the board of directors should positively influence firm performance. Undeniably, greater diversity of human and social capital could provide a wider range of alternatives to cope with the complicated problems faced by the firms (Pitcher & Smith, 2001; Schneider & Angelmar, 1993). However, it could hamper effective discussion during the board meeting. This is because the individual directors who possess a wide range of backgrounds and

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have different sources of information may provide a variety of points of view in the meeting, which could confuse the manager in making a final decision (Maznesvski, 1994). This would impede the managing activities in the firm (Jackson, May, & Whitney, 1995). The contradictory arguments support the worthiness of investigating the relationship between firm performance and diversity in board's human capital and social capital from an empirical point of view.

Previous studies focussing on diversity in human and social capital of the board of directors do not take into account of the industry-specific factors which may have influences on the firms' outcomes. 2012 corporate governance code of Hong Kong suggests that board diversity of individual firm should be flexible according to the firm's business model and specific needs.[3] It gives the notion that the best mixture of human capital and social capital of the board of directors in the firms should be varied between industries due to variation of the environment situated. Certain industries such as manufacturing, agriculture and information technology industries strongly require specific knowledge and skills to conduct the core businesses. The human capital of the board of directors in these industries may be more important to the decision making, rather than the social capital of the board of directors. However, in the service industries such as hotel, travel agency and other tourism-related industries, the social capital of the board of directors may be more important to the decision making, of which the resources obtained through the external network ties could be more pragmatic to improve the quality of the services providing to the customers. For instance, in a hotel firm, the board's external network tie with travel agency may facilitate the collaboration to improve the travelling experience of the tourists staying in the hotel. Herein, ignoring industry-specific influence may be the factor leading to the inconsistent findings upon the effect of diversity in board's human capital as demonstrated in the previous studies such as Kim and Lim (2010), Wellalage and Locke (2013), Goodstein, Gautam, and Boeker (1994), Wincent et al. (2010) and Wincent, Thorgren, and Anokhin (2014).[4]

Even, previous studies merely focus on single aspect of diversity either in human capital or social capital of the board of directors, for instance Carpenter and Westphal (2001), Wincent et al. (2010) and Kim and Lim (2010). Literature search of this study find that neither study focuses on both aspects of diversity in human capital and social capital. It implies that the present literature could not make a solid comparison between the effects of diversity in human capital and social capital of the board of directors with respect to firm performance. In other words, the findings of this area of research are still unable to give us a notion upon either one of the aspects of the diversity is more significant to influence firm performance in the context of tourism industry. The unknown has shed light on the worthiness of this study to the tourism literature.

Herein, this study aims to fill the research gap by investigating the relationship between firm performance and diversity in human capital and social capital of the board of directors, in the context of the tourism industry. The rationale of selecting tourism industry is that the supervisory role of the board of directors over strategic planning and implementation is relatively more pronounced in tourism firms. This is due to the highly unstable environment in the tourism industry (Orfila-Sintes, Crespi-Cladera, & Martinex-Ros, 2005; Sundbo, Orfila-Sintes, & Sorensen, 2007), of which tourism demand is likely to be influenced by a number of factors such as tourist income, inflation, the prices of tourism products, the fluctuation of exchange rates, the word-of-mouth effect, as well as the seasonal climate change. Unlike other industries such as manufacturing, agriculture and automotive, which do not demand much strategic change, tourism firms are required to frequently revise their strategies to best fit the rapidly changing environment (Pechlaner & Sauerwein, 2002). A great deal of innovation is essential for tourism firms to increase their competitiveness, for instance, through the introduction of new products such as customisation and the ICT interaction approach (Sundbo et al., 2007; Weiermair, 2006). By these means, board's human capital and social capital are important to provide a better quality of supervision of the strategic position of tourism firms to ensure that the firms are able to adapt to the changing environment.

The premium of focussing on tourism-specific industry only enables this study to further investigate whether the exogenous crises such as natural disasters, disease outbreaks, war/terrorism and economic/financial downturn could make a significant influence towards the relationship between firm performance and diversity in human and social capital of the board of directors. The underlying reason of this investigation is that the board becomes more proactive and less likely to be influenced by the managers in a crisis period because the managers' bargaining power tends to be decreased during the turbulence and when firm performance declines. Turbulent circumstances could maximise the mobilisation of board power to request strategic change to drive the firm to adapt to the changing environment (Hermalin & Weisbach, 1998). This indicates that the influence of the board becomes more pronounced in a crisis period. Herein, a research issue may be raised regarding the advantage and disadvantage of adopting greater diversity in board's human and social capital, and which of the approaches would be preferable to the other and exert greater influence on firm performance during a crisis period. On the one hand, one could say that the advantage of adopting greater diversity in human capital and social capital should be magnified as it could hasten the process of finding a solution/the appropriate responses to cope with the crisis; on the other hand, one could say that greater diversity could delay the decision-making process, which could possibly result in missing the best time to exploit the competitive advantages in the market during a critical crisis period. The two contradictory possibilities have motivated this study to further investigate the existence of the moderating effect of crises to the relationship between firm performance and diversity in human and social capital of the board of directors.

The remainder of this paper is organised as follows. Section 2 presents a literature review of diversity in board's human capital and social capital. Section 3 discusses the data and model construction. In Section 4, we provide summary statistics of the variables and the empirical results. Section 5 explores the robustness of the results, and lastly, Section 6 provides the conclusions and implications of the study.

2. Diversity in human and social capital of the board of directors

Human capital refers to the knowledge, skills and abilities to generate a given set of outcomes (Becker, 1983; Hitt, Bierman, Shimizu, & Kochhar, 2001). Studies such as Gradstein and Justman (2000) and Soutaris (2002) document the advantage of adopting

[3] 2012 corporate governance code of Hong Kong makes the statement that "Board diversity will differ according to the circumstances of each issuer. Diversity of board members can be achieved through consideration of a number of factors, including but not limited to gender, age, cultural and educational background, or professional experience. Each issuer should take into account its own business model and specific needs, and disclose the rationale for the factors it uses for this purpose".

[4] To our knowledge in this study, only one empirical paper is found focusing on diversity in board's social capital, i.e. Carpenter and Westphal (2001). In this case, we cannot conclude any inconsistent findings upon the effect of the diversity towards the firms' outcomes. The lack of research in this perspective is also an added value to the present study.