

# The impact of nationality diversity on financial performance among manufacturing companies listed on the Indonesia Stock Exchange

Umi Mardiyati<sup>1,\*</sup>, M. Edo Suryawan Siregar<sup>1</sup>  
<sup>1</sup>Faculty of Economics Universitas Negeri Jakarta

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## Abstract

*This study aimed to determine the effect of commissioner nationality on the financial performance of manufacturing companies listed on the Indonesia Stock Exchange from 2015–2017. The results (after controlling for gender, board size, firm size, leverage, and liquidity) show that the presence of foreign commissioners on the board of commissioners does not significantly affect companies' financial performance. A robustness test confirmed the regression results.*

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## 1. Introduction

According to the Financial Services Authority and in line with the interests of investors, a company's organizational structure and operations are the main concerns regarding corporate governance, as they ensure fairness, responsibility, and transparent and accountable corporate behavior (FSA, 2014). Therefore, both public and non-public companies must see good corporate governance not as a trivial endeavor but as an effort to improve company performance and value.

The board of commissioners has an important role in a company's organizational structure, as commissioners are essential to creating good corporate governance and ensuring the operation of the company's control system. In other words, commissioners make sure that good financial performance is achieved according to the wishes of investors. Several research results have confirmed the influence of boards of commissioners on companies' financial performance (O'Connell and Cramer, 2010; Kang and Kim, 2011; Al Manaseer et al., 2012; Tulung and Ramdani, 2016).

The characteristics of a board of commissioners, including the nationality of its members, can support the effectiveness of the board's efforts to carry out its obligations to supervise the board of directors (Dewi et al., 2018). In this way, the board of commissioners ensures the achievement of the company's goals (most notably, the success of implementing good corporate governance). The nationality of a board of commissioners (i.e., whether foreign citizens are present on a board of commissioners) is often measured in research. Ararat et al. (2010) showed that diversity in the nationalities of commissioners (indicated by the inclusion of foreign commissioners or commissioners who represent ethnic minorities) positively influences firm value. However, their research was conducted in Norway and Sweden, which follow a system between a one-tier system and a two-tier system.

Research conducted in countries that adhere to a one-tier system, such as the United States, shows different results, as evidenced by Eulerich et al. (2014) and Arquisola et al. (2018). In such countries, the presence of foreign nationals on the board of commissioners reduces a company's performance. This is because significant internationality on a board can reduce communication between board members, and large age differences can ease the decision-making process. Meanwhile, according to Carter et al. (2010), the presence of foreign nationals on a board of commissioners has no influence on a company's financial performance.

Based on the studies described above, the research results are inconsistent. Therefore, the present research was carried out to empirically re-examine how the nationality diversity of a board of commissioners affects companies' financial performance.

## 2. Literature review and hypothesis development

### 2.1. Agency theory

Agency theory, which was first introduced by Jensen and Meckling in 1976, underlies the financial performance of companies. Ehikioya (2009) explained that there is a conflict of interest between the principal owners (investors or shareholders) and agents (managers). Managers who know more about the company cause managers are often more concerned with themselves than the interests of shareholders or investors. If an agency problem exists within a company, it must be overcome by carrying out various company controls, by increasing ownership, and by providing incentives to managers. Such steps are essential to protecting investors' interests by ensuring that management act appropriately. Reducing or eliminating agency problems improves a company's financial performance.

The decisions made by a company's managers must be supervised to prevent or overcome unexpected problems for shareholders. Good corporate governance mechanisms act as a form

of control, as good practices need to be applied to maximize performance. Companies that implement good corporate governance require parties to oversee the implementation of commissioner policies. Therefore, foreign commissioners are a part of corporate governance that are essential for setting strategies and controlling the operations of a company such that managers act in ways that maximize the company's performance and achieve company goals (Dewi et al., 2018).

## 2.2. Hypothesis development

As mentioned in the introduction, nationality diversity on a board of commissioners increases firm value among companies in Norway and Sweden (Ararat et al., 2010). Kesaulya and Febriany (2018) also revealed that the presence of foreign nationals on a board of commissioners positively benefits companies. The reason for this is that potential investors assume that the presence of foreign nationals means that the company is run competently; thus, they are more likely to invest in such companies. Therefore, the following hypothesis is proposed:

H1: National diversity on a board of commissioners positively affects corporate financial performance.

## 3. Research methods

### 3.1. Sample

The research sample comprises 65 manufacturing companies listed on the Indonesia Stock Exchange for three consecutive years from 2015–2017 (165 observations). The sample criteria used are:

- Manufacturing companies listed on the IDX for all years from 2015–2017.
- Manufacturing companies that consistently published annual financial statements in Rupiah currency ending on December 31 from 2015–2017
- Manufacturing companies that presented audited financial statements from 2015–2017 with unqualified opinions.
- Manufacturing companies that generated profits from 2015–2017.

### 3.2. Variables

Table 1 shows the independent variable, dependent variable, and control variables considered in this study.

**Table 1. Operational variables**

Variable	Type	Indicator	Scale
Firm performance	Dependent variable	ROA = Net income / total assets	Ratio
Nationality	Independent variable	Foreign members / total members on the board of commissioners	Ratio
Gender	Control variable	Female members / total members on the board of commissioners	Ratio
Board size	Control variable	Number of members on the board of commissioners	Nominal
Firm size	Control variable	Ln total assets	Ratio
Leverage	Control variable	DAR = Total debt / total assets	Ratio
Liquidity	Control variable	Current ratio = Current assets / current liabilities	Ratio

## 4. Results

### 4.1. Descriptive statistics

The descriptive statistics results based on 195 research observations of manufacturing companies show that financial performance, as measured by return on assets (ROA), has a minimum ratio value of 0%, a maximum ratio value of 78.14%, and an average ratio value of 8.99% (Table 2). The standard deviation value is 10.4%.

**Table 2. Descriptive statistics**

	Mean	Median	Max	Min	SD	Obs
Nationality	0.7552	0.0000	7.0000	0.0000	1.4132	195
Gender	0.1194	0.0000	0.7500	0.0000	0.1780	195
Board size	4.3906	4.0000	13.0000	2.0000	1.9706	195
Firm size	28.4535	28.2051	33.3202	24.9028	1.6268	195
Leverage	5.4381	0.8512	32.1510	0.0761	10.3875	195
Liquidity	4.26E+10	1.9264	8.18E+12	0.0257	5.90E+11	195
ROA	0.0899	0.0638	0.7814	0.0002	0.1041	195

**Table 3. Correlation matrix**

	Nationality	Gender	Board size	Firm size	Leverage	Liquidity
Nationality	1	-	-	-	-	-
Gender	0.23	1	-	-	-	-
Board size	0.09	-0.52*	1	-	-	-
Firm size	-0.33*	0.41	-0.12	1	-	-
Leverage	0.15	0.39	0.28*	0.62	1	-
Liquidity	0.40	-0.59	0.45	-0.05	0.21**	1

Significance is indicated at the 10% (\*) and 5% (\*\*) levels.

### 4.2. Multicollinearity test

Table 3 shows that there is no correlation above 0.8. Thus, it can be concluded that none of the variables experience high multicollinearity.

### 4.3. Chow test

The Chow test determines whether a model should use fixed effects or common effects. If the result of the chi-square probability is less than the p-value, a fixed-effect model is used. The results of the estimation using the fixed specification effect are presented in Table 4 below.

**Table 4. Redundant fixed effect-likelihood ratio**

Effect Test	Probability
Cross-section F	0.0000
Cross-section chi-square	0.0000

As the chi-square probability is 0.0000, a fixed-effect model was selected for this research, which is better than a common-effect model.

### 4.4. Hausman test

This test determines whether the fixed-effect model is more appropriate than a random-effects model as a research tool. If the result of the chi-square probability is less than the p-value, then the random-effects model should be used. The results of the estimations using random specification effects are provided in Table 5.

**Table 5. Hausman test**

Test Summary	Chi-Sq. Statistic	Probability
Cross-section random	4.776700	0.5728

The result of the chi-square probability shows a value of 0.5728 (which exceeds the p-value of 0.05). This means that the research model should use a fixed effect research model.

#### 4.5. Discussion

Based on the results of panel data regression in Table 6, the research hypothesis is rejected. This is evidenced by a probability value of 0.6486 (>10%) and a t-value of 0.4567. This outcome contrasts with the results of Ararat et al. (2010), who indicated that the presence of foreign nationals on a board of commissioners improves companies' financial performance in countries with systems that are between a one-tier system and a two-tier system, namely Norway and Sweden.

Nevertheless, the present results support the research of Carter et al. (2010) and Fidanoski et al. (2014), who reported that the presence of foreign commissioners on a board does not influence a company's financial performance. Foreign commissioners on the board do not provide different experiences from members of the board of commissioners of Indonesian citizens (Herdhayinta, 2014). Therefore, the election of foreign nationals as commissioners does not significantly contribute to a company's value (Herdhayinta, 2014). Thus, the nationality of foreign nationals cannot always be used as a benchmark for assessing a company's competence and should not receive when an investor decides what companies to invest in (Suhardjanto et al., 2017).

**Table 6. Regression results**

Variable	$\beta$	SE	t <sub>stat</sub>	Sig t
Constant (C)	1.4436	0.6235	2.3153	0.0223**
Nationality (X <sub>1</sub> )	0.0067	0.0147	0.4567	0.6486
Gender (X <sub>2</sub> / control)	0.0109	0.0549	0.1994	0.8423
Board size (X <sub>3</sub> / control)	0.0079	0.0103	0.7724	0.4415
Firm size (X <sub>4</sub> / control)	-0.0489	0.0219	-2.2261	0.0278**
Leverage (X <sub>5</sub> / control)	-0.0006	0.0003	-1.9392	0.0548*
Liquidity (X <sub>6</sub> / control)	5.07E-15	6.48E-15	0.7812	0.4362
R-squared	= 0.8973	a. Predictors: (Constant)		
F value	= 15.4545	▪ Nationality		
Sig.F	= 0.0000	b. Dependent Variable:		
		▪ ROA		

\*\*, \*Significant with a level of significance ( $\alpha$ ) = 5% & 10%

#### 4.6. Robustness test

This study also included a robustness test in which the measurement of the financial performance of manufacturing companies was replaced using Tobin's q ratio. This ratio was used because it can provide an overview of a company's fundamental aspects and market views (i.e., the extent to which outside parties, including investors, assess the company). The panel data regression results are provided below in Table 7.

The results of the panel data regression test confirm nationality characteristics do not significantly affect financial performance as proxied by Tobin's Q ratio. These results are the same as those derived from the first model, in which the company's financial performance was measured by ROA.

**Table 7. Robustness test**

Variable	$\beta$	SE	t <sub>stat</sub>	Sig t
Constant (C)	-2.1322	10.5335	-0.2024	0.8399
Nationality (X <sub>1</sub> )	-0.0663	0.2497	-0.2656	0.7909
Gender (X <sub>2</sub> / control)	-0.5661	0.9278	-0.6101	0.5429
Board size (X <sub>3</sub> / control)	0.0382	0.1743	0.2192	0.8268
Firm size (X <sub>4</sub> / control)	0.1350	0.3711	0.3639	0.7165
Leverage (X <sub>5</sub> / control)	-0.0013	0.0060	-0.2235	0.8235
Liquidity (X <sub>6</sub> / control)	-3.29E-14	1.10E-13	-0.3000	0.7647
R-squared	= 0.9666	a. Predictors: (Constant)		
F value	= 51.2116	▪ Nationality		
Sig F	= 0.0000	b. Dependent Variable:		
		▪ Tobin's Q		

## 5. Conclusion

This study determined that nationality diversity on a board of commissioners does not affect companies' financial performance. Foreign members on a board of commissioners do not provide experiences different from members who are Indonesian citizens (Herdhayinta, 2014). Therefore, the selection of foreign nationals as members of the board of commissioners does not significantly contribute to a company (Herdhayinta, 2014). As a managerial implication, this research provides reason for shareholders to hire commissioners with educational backgrounds (namely, in economics and business) in their job descriptions. In addition, the results indicate that commissioners who have no previous experience in other companies should not be hired. A suggestion for future research is to add independent variables that increase financial performance, such as the age, educational background, and length of service of the members of boards of commissioners.

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