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## The Board Mix of Maltese Listed Entities and its Corporate Governance Implications

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### **Abstract:**

**Purpose:** The objectives of this study were (i) to ascertain the Board mix of selected Maltese Listed Entities (MLEs) and how this has changed, if in any way, in the years 2018-2022, (ii) to extract the impact of the main factors affecting the Board mix, and (iii) to assess the extent to which the Board mix is perceived as contributing to good Corporate Governance (CG).

**Methodology:** A mixed methodology was adopted. Thirty-one semi-structured interviews were conducted with eleven directors, nine company secretaries, four CFOs and two CEOs of MLEs, together with three corporate advisors, one corporate lawyer and one MLE expert.

**Findings:** Independent Non-executive Directors (INEDs) are appreciated in the Boards of MLE, but the Board mix varies significantly among MLEs. The main factors affecting the Board mix of MLEs are the scope and complexity of the entity's operations, CEO entrenchment, the directors' knowledge on the entity's key functions and the directors' nationality. NEDs (Non-executive Directors) and INEDs contribute towards strategy formulation, the prevention and detection of corporate irregularities, and enhanced transparency in financial reporting. Meanwhile, EDs (Executive Directors) contribute towards strategy execution and may even aid in preventing and detecting corporate irregularities.

**Originality/Value:** Although much ink has been spilled on Board of Director issues, too few studies have as yet delved into the different types of directors. This paper sheds light on the

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*optimal Board mix within a small-state context that ensures good CG and also on the factors that may necessitate a change to such Board mix.*

**Keywords:** *Board mix, Corporate Governance, Maltese Listed Entities, Board of Directors.*

**Paper type:** *Research article.*

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## **1. Introduction**

The mainstay of Corporate Governance (CG) is the Board of Directors (*Board*), the highest echelon of an entity. An effective Board is composed of an appropriate mix of executive directors (*EDs*), non-executive directors (*NEDs*) and independent NEDs (*INEDs*) (MSE n.d.). Only EDs are entrusted with the daily running of the entity (Baldacchino 2017), while NEDs/INEDs serve as Board members. To classify as independent, NEDs need to have no present or past ties with the entity and so, demonstrate independence of mind, information and income (McCabe and Nowak, 2008). For Maltese Listed Entities (MLEs), the Code of Principles of Good Corporate Governance (*Code*) suggests that, at least, one-third of the directors are NEDs, most of whom are INEDs (MFSA 2011).

The objectives of this research paper are (i) to ascertain the Board mix in each of the selected MLEs and how this has changed, if there was any change, in the years 2018-2022, (ii) to extract the impact of the main factors affecting the Board mix, and (iii) to assess the extent to which the Board mix contributes to good CG. According to Magnanelli and Pirolo (2021), the findings differ depending on the country where the study is performed because CG is not globally standardised.

This study has been conducted in Malta, a small European island-state. It hopes to raise awareness amongst MLEs on the importance of Board mix to good CG, together with the factors which affect such a mix. The proposed recommendations may aid MLEs in composing a Board mix that suits their specific needs and enable competent authorities to provide more guidance.

## **2. Literature Review**

### **2.1 The Development of Board Mix**

Originally, Boards were mainly made up of EDs but, during the 1970s, entities in the United States (US) started replacing EDs with NEDs/INEDs through a voluntary process (Baysinger and Butler, 1985). A recent study in the US by Chung, Liu et al., (2019) illustrated that NEDs/INEDs even gained supermajority. This trend also

featured in other countries, albeit more slowly (Dahya and McConnell, 2005). The main driver shaping this pattern over time is the imposition of institutional and regulatory pressures (Coles *et al.*, 2008). It could also have been due to shareholder activism (Linck *et al.*, 2008), the burdening of NEDs/INEDs with more responsibilities (Pye and Camm, 2003) and/or the transformation into a public entity (Boone *et al.*, 2007).

## **2.2 Factors Affecting the Board Mix**

The Board mix is affected both by entity-specific and by director-specific factors (Garner *et al.*, 2017). The entity-specific factors found in the literature to be relevant to Board mix are the following:

### **2.2.1 Scope and Complexity**

As entities grow larger, age or enter into new product or geographical lines, they onboard more NEDs/INEDs (Boone *et al.*, 2007; Chung *et al.*, 2019, Coles *et al.*, 2008; Fraile and Fradejas, 2012; Lahlou, 2018). Similarly, entities with high financial gearing have a higher proportion of NEDs/INEDs because such entities necessitate more advice (Coles *et al.*, 2008; Lahlou, 2018) and monitoring (Bushman *et al.*, 2004; Monem, 2013). This is disputed by García Martín and Herrero (2018) on the grounds that monitoring is partly carried out by debt holders.

### **2.2.2 Information Asymmetry**

It has long been recognised that NEDs/INEDs have inferior entity-specific information compared to EDs (Zattoni and Cuomo 2010). This is even more so in entities with high spending on research and development, growth opportunities or stock return volatility (Chung *et al.*, 2019). Consequently, often fewer NEDs/INEDs feature on Boards (Lahlou 2018; Linck *et al.*, 2008; Monem, 2013). Meanwhile, Boone *et al.* (2007) and Chung *et al.* (2019) declare that information asymmetry does not impact the Board mix.

### **2.2.3 CEO Entrenchment**

CEO entrenchment is a gauge of the CEO's influence on the directors' decisions (Chung *et al.*, 2019). This is fostered by CEO duality, good entity performance and CEO ownership of an entity's shares (Monem, 2013). CEO duality is not relevant in the case of Malta because all MLEs abide by the Code's recommendation for a "*clear division of responsibilities*" between the chairperson and the CEO (MFSA 2011, p. 3). Boone *et al.* (2007), Chung *et al.* (2019) and Pascual-Fuster and Crespí-Cladera (2022) have discovered that CEO entrenchment results in a decrease in the proportion of NEDs/INEDs because the CEO uses his/her power in the boardroom to create a 'friendlier' Board of EDs and lessen the monitoring.

Only if the CEO's power is controlled through, for example, the shareholder presence of NEDs or a venture capitalist, the NEDs/INEDs in the boardroom increase (Boone *et al.*, 2007). Despite this, Raheja (2005) emphasises the need for

more NEDs/INEDs so as to hold the entrenched CEO in check. Contrastingly, Linck *et al.* (2008) argue that, with CEO ownership, the CEO's interests become aligned with those of the shareholders, thus reducing the need for monitoring by NEDs/INEDs.

#### **2.2.4 Ownership Structure**

Entities with high ownership concentration tend to have a lower proportion of NEDs/INEDs in the boardroom than those with scattered ownership (Monem, 2013; Pascual-Fuster and Crespí-Cladera, 2022). This is due to the fact that the large shareholders themselves exercise strong control over the actions of management (García Martín and Herrero, 2018) and there is a lower possibility that inferior projects are undertaken (Raheja, 2005).

Quoted entities in European countries, in contrast to those in the US, tend to have high ownership concentration (Boone *et al.*, 2007; Linck *et al.*, 2008; Pascual-Fuster and Crespí-Cladera, 2022) and this has also been confirmed by Baldacchino (2017) for Malta, where most MLEs have one major shareholder owning 51% or at least between 30% and 50% of the entity's shareholding.

#### **2.2.5 Board Size**

Beiner *et al.* (2004) have shown that Board mix is a CG mechanism independent of Board size. In this context, Mak and Roush (2000) argue that Board size influences the Board's monitoring role because a large Board is able to monitor management better than a small Board. This in turn implies that there is a link between Board mix and size in that fewer NEDs/INEDs may be needed in large Boards (Mak and Roush 2000). However, with large Boards, the risk remains that some directors may become free-riders and rely unduly on other directors to carry out their duties (Beiner *et al.*, 2004).

The director-specific factors found in the literature to be relevant to Board mix are the following:

#### **2.2.6 Tenure**

Over the length of service on the same Board, NEDs/INEDs build close ties with EDs and this potentially impairs the independent and objective view of NEDs/INEDs (Pass, 2004). Indeed, the Code stipulates that an entity should ascertain whether INEDs who have sat on the Board for a tenure exceeding twelve years are still independent (MFSA, 2011) and therefore still render the Board mix effective.

#### **2.2.7 Nationality**

Foreign NEDs/INEDs may monitor and scrutinise EDs more objectively than local NEDs/INEDs (Pass, 2004). In contrast, Deng *et al.* (2020), Firoozi *et al.* (2019) and Masulis *et al.* (2012) have found that foreign INEDs reduce the monitoring intensity, while local INEDs reduce the possibility of corporate misconduct. However, Firoozi

*et al.* (2019) also recognise the added value of those foreign directors residing locally because, like local directors, these have easier access to soft information on the specific country and domestic information networks. Indeed, entities favour NEDs/INEDs residing in the same city (Deng *et al.*, 2020).

### **2.2.8 Gender**

Terjesen *et al.* (2015) claim that the underrepresentation of female directors is relevant to the effectiveness of the Board mix because NEDs/INEDs tend to contribute more positively to the entity when surrounded by female directors. This may be a main reason why the European Union has stipulated that by 2026, 40% of NEDs/INEDs in listed entities are to be females (Vella and Cardona, 2022). Moreover, according to Frye and Pham (2018), even the presence of a female CEO tends to affect the Board mix as it is often accompanied by a lower ratio of EDs to NEDs/INEDs.

### **2.2.9 Skills and Competencies**

Directors need to possess knowledge on the entity's key functions. Coupled with this, the presence of skilled and competent NEDs/INEDs is imperative for the Board (Zattoni and Cuomo, 2010). With increased complexity, entities demand directors with different academic backgrounds (Anderson *et al.*, 2011), encompassing the traditional sphere of management, such as marketing and accounting, and other spheres needed to manage the affiliation with the environment, such as law and politics (Zattoni and Cuomo 2010).

## **2.3 The Contribution of Board Mix to Good CG**

The contribution of Board mix to good CG depends on the roles of the different types of directors with regards to strategy formulation and execution, the prevention and detection of corporate irregularities, the enhancement of transparency in financial reporting, the multiple commitments of NEDs/INEDs, the enculturation of boardroom openness and the type of director in the majority.

### **2.3.1 Strategy Formulation and Execution**

NEDs/INEDs are predominantly involved in strategy formulation (Azlan and Annuar, 2014) in terms of evaluating the strategy proposed by EDs (Pass, 2004). They may even participate in pre-annual plans and brainstorming sessions (Azlan and Annuar, 2014). Once the strategy is approved at Board level, EDs provide the leadership to execute it (Azlan and Annuar, 2014; Pass, 2004).

Although NEDs/INEDs are not involved in strategy execution, they may still want to ensure that the strategy is actually executed in line with what has been approved (Schmidt and Brauer, 2006). Moreover, there may be instances where the initial strategy has to be modified owing to difficulties encountered in its execution (Azlan and Annuar, 2014). In this connection, Baldacchino (2017) suggests appointing

directors for a reasonable number of years rather than renewing their appointment every year, and this to enable them to implement long-term strategies.

### ***2.3.2 The Prevention and Detection of Corporate Irregularities***

One of the key pillars of good CG is accountability to shareholders, other stakeholders and the local community (Sant, 2003). This is achieved by inquiring and challenging from NEDs/INEDs (Robert *et al.*, 2005). As a result, EDs and management are reluctant to engage in misconduct for their personal interest (Fuji, *et al.*, 2016). NEDs/INEDs instinctively avoid aberrant managerial behaviour because this harms their repute and negatively affects the demand for their service (Ahmed *et al.*, 2006). On the contrary, they would want to create the image of vigilant monitors so that they acquire directorships in additional entities (Neville *et al.*, 2019). Thus, NEDs/INEDs aid in preventing and detecting corporate irregularities.

### ***2.3.3 The Enhancement of Financial Reporting Transparency***

Another pillar of good CG is transparency as this instils confidence and trust amongst all the stakeholders (MFSA, 2020). The oversight of financial reporting rests with the audit committee (Camenzuli, 2017). The drive towards Board independence reinforces the representation of INEDs on the audit committee (Duchin *et al.*, 2010).

Neville *et al.* (2019) affirm that audit committee independence is more influential in curbing both financial and non-financial corporate misconduct than Board independence. Firstly, INEDs on the audit committee are more able to assist in internal audits than EDs, NEDs or INEDs who do not sit on this committee. Secondly, INEDs on the audit committee tend to back up more the appointment or retention of external auditors (Neville *et al.*, 2019).

### ***2.3.4 The Multiple Commitments of NEDs/INEDs***

Multiple commitments present two sides of the same coin. On one side, these add to the directors' luggage of experience (Pass, 2004). Moreover, serving on more than one Board grants access to essential resources, networking connections with other entities and wealth of knowledge on business practices (Harris and Shimizu, 2004). On the other side, NEDs/INEDs with multiple commitments may become "overboarded" and "stretched" (Harris and Shimizu 2004, p.776), this implying that they will not be in a position to bestow adequate time and attention to all their responsibilities (Pass, 2004).

### ***2.3.5 The Enculturation of Boardroom Openness***

Although an increase in the number of INEDs is a visible sign of Board effectiveness for investors (Higgs, 2003), it is not merely the quantity of INEDs that should be considered but also their quality (Kim and Lim, 2010). Moreover, the appointment of INEDs should not be affected in any way by the personal, business or political connections of the major shareholder (Tabassum and Singh, 2020).

The Board is actually effective in “*a culture of openness and constructive dialogue*” (Higgs, 2003, p.33). This facilitates the information flow among the directors (Hsu and Wu, 2014) and ensures that they discern their honest opinion even when it diverges from that of the CEO or management (Zattoni and Cuomo, 2010). For such a culture to thrive, directors’ relationships need to be built on trust.

Owing to their common ties with the entity, mutual trust may be established between EDs and NEDs, this resulting in a healthy collaborative working relationship (Adams and Ferreira, 2009). However, INEDs are generally strict monitors who cause tension and may diminish valuable interactions among the directors because EDs loath rigorous oversight (Hsu and Wu, 2014).

### **2.3.6 The Type of Director in the Majority**

The trend for a Board dominated by NEDs/INEDs places them in a better position to challenge the actions of the EDs than a Board having only one NED/INED who may end up following the majority (Fuzi *et al.*, 2016). Nevertheless, some entities still persist in onboarding EDs owing to their possession of rich and credible information on the entity’s internal processes and daily undertakings (Shakir, 2008). Regulators and policymakers have tarnished the EDs’ valuable contribution in the boardroom (Bhagat and Black, 2002).

Like EDs, NEDs/INEDs may have conflicting interests despite satisfying the official independence requirements (Fairfax, 2010). They rely on information acquired from EDs who may withhold or ‘colour’ the information in such a way to safeguard existing privileges or conceal poor performance (Hooghiemstra and Van Manen, 2004). In turn, NEDs/INEDs cannot make informed decisions (Zattoni and Cuomo, 2010) and doubts also arise on their ability to fulfil their “watchdog role” effectively (Hooghiemstra and Van Manen, 2004, p.1).

The roles of EDs, NEDs and INEDs are different yet complementary (Harris and Shimizu, 2004) and it is their coming together which results in an ideal Board mix (Baysinger and Butler, 1985; Fairfax, 2010). The best way forward is for every entity to find its own balanced Board mix (Boone *et al.*, 2007; Pascual-Fuster and Crespí-Cladera, 2022) because there is no “one-size-fits-all” (Coles *et al.*, 2008; Lehn *et al.*, 2009). Indeed, Fernández-Temprano and Tejerina-Gaite (2020) urge caution before prescribing any specific Board mix.

## **3. Research Methodology**

### **3.1 The Research Tool**

Semi-structured interviews (SSIs) were deemed to be the most suitable research tool because these would be very versatile in gathering reliable and valid data to answer the research objectives (Saunders *et al.*, 2016). The interview schedule (*Annex 1*) contained both closed-ended and open-ended questions, which were standardised

and asked in a systematic order so that the data collected would be comparable and evaluated statistically (McIntosh and Morse, 2015).

However, participants were offered the flexibility to provide their insights when answering open-ended questions. Probes and follow-up questions were used to stimulate the respondents to open up on preliminary responses or to elucidate some points which arose during the interview (Wahyuni, 2012). According to McIntosh and Morse (2015, p. 5), *“the dual qualities of replicability and flexibility yield pertinent as well as rich data”*.

The interview schedule devised for this study was appropriate for both MLE representatives and CG experts (CGEs). However, two questions were specifically focused on MLE representatives and did not apply to CGEs. Another question was amended for CGEs to ask them on MLEs in general. For the closed-ended questions, a five-point Likert scale was used with ‘0’ being strongly disagree and ‘4’ being strongly agree.

### **3.2 The Sample Population**

The Official List of MLEs was found on the MSE website. A total of thirty-one interviews were conducted. Twenty-six of these interviews were carried out with MLE representatives, consisting of eleven directors, nine company secretaries, four CFOs and two CEOs. These were the chosen population for this study owing to their contribution and involvement in the CG of MLEs. In all, they represented twenty-seven MLEs since some participants sat on the Board of more than one MLE. Five further interviews were conducted with CGEs, encompassing three corporate advisors, one corporate lawyer and one MLE expert. The views of these participants were deemed to be significant in obtaining a holistic and thorough understanding on the research area.

### **3.3 Data Analysis**

Interview transcripts and notes written down during the interviews enriched the data analysis. Qualitative data was sourced from the open-ended questions as well as the comments added by some respondents on their ratings of the Likert scale questions. This was analysed using the thematic approach (Wahyuni, 2012) whereby the transcripts were summarised and the different responses were compared to identify the emerging themes.

Quantitative data was sourced from the closed-ended questions. The Chi-Square Test was used to investigate the association between MLEs and their Board characteristics, such as, Board mix and directors’ tenure and the association between MLEs’ industries and Board mix. The Friedman Test was used to compare the mean rating scores obtained on the statements relating to the entity-specific and director-



specific factors and then conclude whether or not the mean rating scores varied significantly.

#### 4. Findings and Discussion

The Board mix and its implications on CG may be seen as analogous to the prescription of medicine to a patient and its effects.

##### 4.1 The Medicine Being Prescribed: The Board Mix

In most MLEs<sub>(17/27)</sub>, INEDs constituted the largest percentage of directors, with three such MLEs<sub>(3/17)</sub> being entirely composed of INEDs. One MLE<sub>(1/27)</sub> had an equal percentage of NEDs and INEDs. On the other hand, six MLEs<sub>(6/27)</sub> had NEDs as the largest percentage, while only three MLEs<sub>(3/27)</sub> had EDs as the largest percentage. All MLEs followed the Code's recommendation that at least one-third of the Board would be composed of NEDs. However, the majority of such NEDs were not INEDs in all MLEs. When combining all the MLEs together, 18.6% were EDs, 24.2% were NEDs and 57.2% were INEDs. The Board mix varied significantly among MLEs (p=approx. 0).

##### 4.1.1 Why are INEDs the largest percentage type of director in most entities?

The development of the Board mix in Malta has replicated the trend experienced in several other countries. The main reasons behind this trend were the pressures imposed by regulators and shareholders, as noted elsewhere by Coles *et al.* (2008) and Linck *et al.* (2008) respectively. In fact, such pressures typically kicked in following a chain of high-profile national and international scandals. NEDs and, in particular, the independence and objectivity of INEDs, were believed to help prevent reoccurrences. In the years 2018-2022, minimal changes emerged from the findings with respect to the Board mix. An added plausible reason for this might be that no recent revisions to the Code's recommendations were made.

The findings also reveal that although Maltese family-controlled MLEs in the second or third generation may need to onboard outsiders to solve the conflicts of interest that start to crop up among the family members, these entities seem to be slower in opening up to NEDs/INEDs than other entities. Contributing to this slowing down in Malta is probably its secretive culture which, as observed by Baldacchino (2017), emanates from the interconnectedness of a small state.

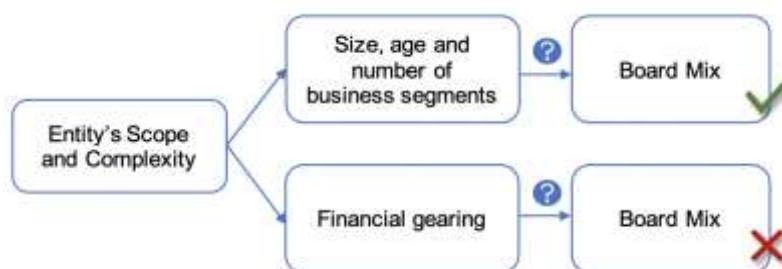
##### 4.2 The Medicine Determinants: Factors Affecting the Board Mix

The most relevant entity-specific factor found to affect the Board mix of MLEs is the scope and complexity of the entity's operations, but specifically that arising from the entity's size, age and new products or locations. As shown in Figure 1, an entity's financial gearing does not seem to bear such an influence in MLEs. This

may be due to the financial institutions not giving too much importance to the Board mix of those entities which approach them to borrow.

Another entity-specific factor found to affect the Board mix of MLEs is CEO entrenchment. In line with Boone *et al.* (2007), Grima, (2021), Chung *et al.* (2019) and Pascual-Fuster and Crespi-Cladera (2022), findings show that the CEO uses the power granted from positive entity performance or ownership to compose the Board in his/her favour, with fewer NEDs/INEDs, even though this results to be detrimental to the entity's monitoring mechanism.

**Figure 1.** Complexity elements and their effects on the Board mix of MLEs



*Source:* Own study.

However, some respondents (15/31) stated that CEO entrenchment actually calls for more NEDs/INEDs. Some other respondents (5/31) stated that this is especially so if the CEO is a significant shareholder. Nevertheless, a more relevant question that remains to be answered is about who is going to take this decision given the CEO's power and influence on the decisions of the directors. One may argue that the imposition of controls on the CEO does result in an increase in the number of NEDs/INEDs, as both findings and Boone *et al.* (2007) reveal.

Perhaps a prerequisite towards increasing NEDs/INEDs could be that of, in the first place, ensuring sufficient participation by the existing NEDs/INEDs. Undoubtedly, it is essential to have a strong chairperson in place since, although the CEO may be in a position to exercise much power, at the end of the day, the personality of the chairperson is pivotal.

Board size also seems to affect the Board mix but exceptions prevail in family-controlled and heavily-regulated MLEs. However, the entity-specific factors of information asymmetry and ownership concentration were not found to affect the Board mix of MLEs.

The director-specific factor most relevant to the Board mix is director knowledge on the entity's key functions, including skills and competencies. The findings reflect a controversy on the extent to which the directors should possess knowledge on the entity's key functions since, while some respondents (4/31) emphasised that all

directors should have this knowhow, another respondent <sup>(1/31)</sup> argued that it was impossible to have any one director knowledgeable in every area.

However, findings echo Anderson *et al.* (2011) that directors should have different skills and competencies. Directors with expertise in different fields in the same Board may challenge one another on account of their various views and knowledge. If directors lack some skills and competencies, entities may always consult with outside advisors. Nonetheless, entities should also step up their efforts in sourcing directors beyond those that have already been tried and tested in other entities.

Although the director-specific factors of tenure and gender were not found to affect the Board mix of MLEs, as shown in Figure 2, nationality is a relevant director-specific factor. Findings show that only 25.8% of the directors in MLEs are foreign, some of whom reside in Malta. This implies that entities favour NEDs/INEDs who reside locally, and this is consistent with the view of Deng *et al.* (2020).

In fact, Malta-residing NEDs/INEDs have a closer relationship with EDs than those residing abroad, which might in turn reduce their monitoring effectiveness, as implied by Pass (2004). Such a viewpoint on monitoring contrasts with Deng *et al.* (2020), Firoozi *et al.* (2019) and Masulis *et al.* (2012) that illustrate that foreign INEDs result in lax monitoring owing to their low participation in Board meetings, their dearth of entity-specific information, their lack of knowledge on the specific country and their limited access to national information channels.

However, it has now become a norm for Board meetings to be held virtually, this facilitating foreign NED/INED attendance and participation and serving as a tool for them to acquire information on the entity. Yet, online Board meetings do not guarantee that NEDs/INEDs residing abroad are at par with locally-based NEDs/INEDs. The implication is that it is better for at least some, if not the majority, of the NEDs/INEDs to be residing locally.

Moreover, it is probably better that Malta-based NEDs/INEDs interact frequently with those residing abroad to help to bridge the gap caused by the distance. Indeed, NEDs/INEDs residing abroad may contribute valuably to the entity, particularly in the case of entities with minimal or no competition in the Maltese scenario and entities that diversify in the countries where the foreign NEDs/INEDs are based.

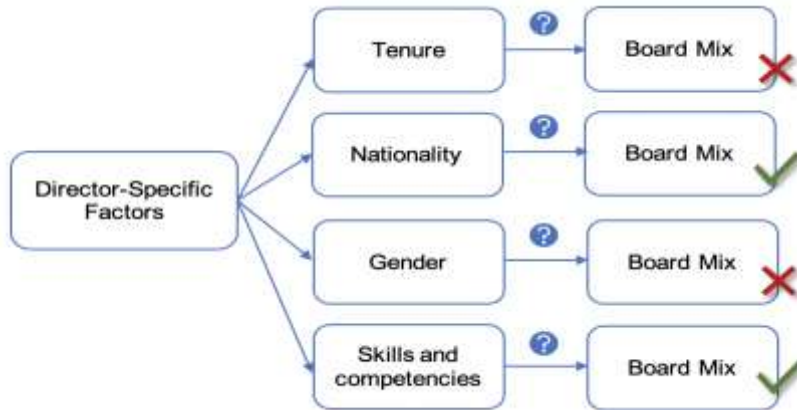
### **4.3 The Effects of the Medicine: The Contribution of a Balanced Board Mix to Good CG**

#### ***4.3.1 Do more NEDs/INEDs on the Board result in less strategy execution?***

Half the respondents <sup>(15/30)</sup> agreed that the Board mix affected both strategy formulation and execution. A clear contribution of NEDs/INEDs was that they brought an outside perspective <sup>(7/15)</sup> and a broader view because of their exposure beyond the entity <sup>(2/15)</sup>. Moreover, by virtue of being independent <sup>(3/15)</sup> and often removed from any ongoing internal politics<sup>(1/15)</sup>, NEDs/INEDs could challenge the

strategic plans proposed by management (11/15) and ask the all-important difficult questions(3/15).

**Figure 2.** Director-specific factors and their effects on the Board mix of MLEs



*Source:* Own study.

Some respondents (7/15) argued that EDs also contributed to strategy formulation because they were aware of what was happening in their entity (4/7), knew the existing limits and what could be achieved (1/7). Meanwhile, two further respondents (2/15) were of the opinion that NEDs/INEDs made a positive contribution to strategy formulation while EDs made a positive contribution to strategy execution.

Other respondents (4/30) believed that only strategy formulation was affected because, as pointed out by Azlan and Annuar (2014) and Pass (2004), once the Board set the strategy to adopt, its execution was then implemented by management (2/4). In this connection, one such respondent (1/4) argued that many NEDs/INEDs tended to slow down the strategy formulation because they were too cautious. Contrastingly, in the view of three further respondents (3/30), only strategy execution was affected. Particularly, a higher number of EDs allowed for a more expedient execution of the strategy (3/3).

Nevertheless, according to Schmidt and Brauer (2006), it is in the interest of NEDs/INEDs to ensure that the strategy is executed according to the approved plan. They are kept informed of the process of the strategy execution through meetings with EDs, progress reports and even surprise site visits.

Moreover, Azlan Annuar (2014) highlight the importance of NEDs/INEDs in strategy execution by underpinning that the strategy is not a plan set in stone but is one to be revised as the need arises. NEDs/INEDs probably need to go beyond strategy formulation and to take timely action to adjust the strategy whenever there is a change in the environment or economic outlook while, at the same time, not stepping on EDs' and management's toes.

After all, the latter need to be given enough resources, time and freedom to enable them to execute the proposed strategy. Nevertheless, NEDs/INEDs involvement in strategy execution ensures the realisation of short-term goals to the eventual achievement of the entity's long-term goal.

#### ***4.3.2 Are NEDs/INEDs more able to contribute than EDs towards the prevention and detection of corporate irregularities?***

Most respondents<sup>(22/31)</sup> agreed that onboarding more NEDs/INEDs helped prevent and detect corporate irregularities. NEDs/INEDs are the “*custodians of governance in an entity*”<sup>(3/22)</sup>. They had a significant concern for their own position<sup>(2/22)</sup> and made sure that everything was done according to best practices<sup>(1/22)</sup> since ultimately, they were personally liable<sup>(3/22)</sup>. Being associated with entities which were reported to have breached regulations and corporate requirements would leave a negative toll on NEDs'/INEDs' name<sup>(1/22)</sup>, echoing Ahmed *et al.* (2006). Thus, as opined by Roberts *et al.* (2005), NEDs/INEDs challenged and asked questions in a determined effort to detect corporate irregularities<sup>(3/22)</sup>.

Contrastingly, a few respondents<sup>(9/31)</sup> held the view that onboarding more NEDs/INEDs did not aid in preventing corporate irregularities. Some such respondents argued<sup>(2/9)</sup> that EDs had a greater day-to-day role in this regard because they were exposed more to the entity than NEDs/INEDs whose main, if not sole function, remained that of attending the Board meetings.

However, this is questionable because EDs build close relationships with management who may even entice them to join or permit any corporate misconduct. Unless such EDs have a strong enough character, many of them may tend not to take the appropriate action. Moreover, lower levels of management may take every possible measure to conceal any corporate irregularities, this rendering it harder for EDs to detect them despite their daily involvement in the entity.

Therefore, NEDs/INEDs may commonly be more able to prevent corporate irregularities in the first place and also, to detect them once they occur. This seems to explain the knee-jerk reaction to reinforce the importance of NEDs, especially INEDs, in the boardroom every time a scandal dominates the headlines.

#### ***4.3.3 Is the contribution of NEDs/INEDs on the audit committee sufficient to justify a more NED/INED balance in the mix?***

According to most respondents<sup>(21/31)</sup>, NEDs/INEDs enhanced transparency in financial reporting through their respective roles on the Board as well as through sitting on committees, particularly the audit committee, in line with Neville *et al.* (2019). EDs were closely involved in the preparation of financial reporting while NEDs/INEDs were in a position to challenge<sup>(4/21)</sup>, scrutinise the financial reports and management accounts<sup>(3/21)</sup>, pose the right questions<sup>(3/21)</sup> and ask for detailed explanations<sup>(1/21)</sup>.

Some respondents (10/31) argued that NEDs/INEDs were not the “authors” of enhanced transparency in financial reporting. Financial reporting was dictated by thorough legislation (6/10) with little room for manoeuvre (1/6). Nevertheless, another respondent (1/6) insisted that the audit committee was the engine where the NEDs/INEDs, EDs and external auditors actually “*triangulate and clash the mines*” towards transparency and integrity of financial reporting.

According to the Listing Rules (Listing Authority – Malta 2021, S.5.117.1/2), the audit committee has to be composed of at least three NEDs/INEDs. This is applicable to all entities and therefore it also applies to small Boards. Possibly, there will be more NEDs/INEDs because, in the first instance, an entity may decide to have more NEDs/INEDs on the audit committee than the minimum requirement of three. Secondly, not all NEDs/INEDs on the Board may be sitting on the audit committee so that, those who do not sit on this committee may speak up and question at Board level. Therefore, there will be limited seats, if any, left for EDs in the boardroom.

#### ***4.3.4 Are NEDs/INEDs with multiple commitments a boon or a scourge to CG?***

Half of the respondents (16/31) were of the opinion that multiple commitments left a negative toll on the performance of NEDs/INEDs. According to eight such respondents (8/16), the more commitments held by NEDs/INEDs, the less time they could dedicate to the entity in question, as was also argued by Harris and Shimizu (2004) and Pass (2004). If they lacked the time to prepare for Board meetings by reading the Board papers in advance, this would impair CG (5/16).

They could even refuse to sit on Board committees (2/16) or attend Board meetings (1/16). Moreover, multiple commitments could be a recipe for conflicts of interest (3/16) and competition issues if a director took on directorships in competing entities (1/16). This is even more relevant within a small state environment.

Contrastingly, some other respondents (8/31) argued that multiple commitments had a positive impact. As long as the directors limited their commitments to the point that the appropriate performance of their duties was assured (3/8), CG would improve because directors could bring in to bear the experience of how other entities had addressed CG issues (5/8), thus improving existing practices (4/8). This was in line with Harris and Shimizu (2004). Three further respondents (3/31) highlighted both the positive and negative impacts of multiple commitments on CG. Meanwhile, other respondents (4/31) argued that the effect of NEDs’/INEDs’ multiple commitments on good CG depended on whether these would impinge upon their duties.

Therefore, NEDs/INEDs with multiple commitments can be either a boon a scourge to CG. This ultimately depends on whether they can juggle all their different commitments and devote sufficient time to properly fulfil their duties. It is understandably difficult, if not impracticable, for the Code to impose a specific number of directorships or commitments a NED/INED should accept because the

responsibilities of directors and, therefore, the time to be committed, vary substantially among entities. Perhaps the matter may be resolved by appropriate action by both prospective NEDs/INEDs and the entities themselves.

On the part of the former, they may themselves opt to decline any directorships for which they know they will not be able to dedicate enough time or which will cause conflicts of interest or competition with the commitments already held. On the part of entities, they may clarify to those interested in such directorships the extent of work and responsibilities to be undertaken as these may vary from one entity to another.

#### ***4.3.5 Are NEDs/INEDs sufficiently more independent than EDs?***

Findings reveal that, on the Board, the EDs are more informed than NEDs/INEDs and, unless the latter press for more information, they will rarely receive it. Indeed, most respondents <sup>(21/31)</sup> affirmed that for NEDs/INEDs to exercise their independence, the Board mix has to foster a culture of openness and constructive dialogue amongst the directors, in line with the view of Higgs (2003). For example, a Board made up of more NEDs/INEDs might be more able to extract information from EDs.

Contrastingly, ten further respondents <sup>(10/31)</sup> were of the opinion that the Board mix was not a prerequisite for a culture of openness and constructive dialogue among the directors because this depended mostly on the directors' personalities <sup>(4/10)</sup> and soft skills <sup>(1/10)</sup>. In this respect, NEDs/INEDs who are likely to yield to consistent pressure arising either from the circumstances of the entity itself or owing to their own not-so strong personality may best decline such a position. Indeed, it is important that the directors sitting on a Board and taking decisions are not unduly influenced.

For a Board to be free and open, a prerequisite to the success of the Board mix is the trust built among the directors. NEDs/INEDs may be more comfortable to exercise their independence and non-executive status within in-camera discussions whereby matters are discussed without management being present. These discussions also serve as a tool to build or break the trust among directors. Therefore, overall, given the appropriate personality, the status of NEDs generally renders them more independent.

#### ***4.3.6 Is the quality of NEDs/INEDs more important than their number?***

The Board is a dynamic organ. It is made up of different characters and personalities. The findings support Kim's (2010) avowal that the quality of NEDs/INEDs should be taken into account together with their quantity. Regardless of the number of NEDs/INEDs sitting in the boardroom, if these do not adequately carry out their responsibilities, they might as well not be there. The problem is to measure their quality particularly before the beginning of director engagement. Perhaps a way of dealing with this is to appoint them on a probationary period of

one year. Then, if their performance is found to be satisfactory, they are given a tenure for a reasonable number of years, as suggested by Baldacchino (2017).

Moreover, another element emerging from the findings and Tabassum and Singh (2020) is related to the appointment of the directors. The litmus test is to ensure that NEDs/INEDs are independent, competent and have the necessary knowhow to be able to sit on the Board, rather than being appointed because someone knows them or is related to them. The Code might help in this direction by stipulating some minimum requirements such as the minimum level of skills and competencies for one to hold the Board position.

#### ***4.3.7 Is there an optimally balanced mix?***

The Board mix varies significantly amongst MLEs and even amongst MLEs' industries, and this implies that an optimally balanced standard mix does not exist. This confirms the various sources in the literature arguing that there is no blueprint for CG as the "optimal" Board mix differs in each entity. Indeed, EDs, NEDs and INEDs all inject valuable contribution but this varies depending on the different circumstances of each entity. Thus, the single-minded drive for an increase in NEDs/INEDs is not necessarily for the greater good.

Most respondents<sub>(22/31)</sub> argued that NEDs/INEDs should be in the majority. This is because, if not, they would end up going with the flow, as was opined by Fuzi *et al.* (2016). Moreover, if Boards had to be dominated by EDs, Board meetings might morph into an executive committee meeting discussing the mundane operations of the entity.

Nevertheless, both findings and literature still acknowledge the valuable contribution of EDs in terms of providing information and receiving guidelines from the Board. In fact, EDs feature as a minority on the Boards of most MLEs. As highlighted by Shakir (2008), this is essentially due to the information asymmetry between EDs on one part and NEDs/INEDs on the other part.

In this respect, one or two EDs might suffice on most Boards. This is believed to be enough in pressing EDs to pass the first-hand information they possess on the entity to NEDs/INEDs which, in turn, enables them to challenge management, apply oversight and ensure that all the necessary rigour is applied into whatever the EDs are doing. Moreover, through the presence of EDs, management will be held responsible for the proposals they present to the Board. This also minimises the risk of segregation between the Board and management.

However, an entity whereby a culture of information sharing is promoted not only through the participation of management in Board meetings but also through informing NEDs/INEDs on relevant issues that arise between meetings, can do even without any EDs. Contrastingly, a family-owned entity may prefer most EDs to be family members so that decisions remain a family affair in as far as it is possible.



Therefore, once the basic principles of CG are both understood and applied, every entity may find it easier to decide its optimally balanced Board mix.

#### ***4.3.8 Can a specific Board mix be prescribed or recommended?***

Fernández-Temprano and Tejerina-Gaite (2020) warn against prescribing a standard balanced Board mix given that there is no one such mix applicable to all entities. While some respondents (18/31) echoed this, others (13/31) favoured a prescription for the sake of ensuring compliance. However, every business has different requirements (6/18), often too varied (1/6), so making a “hard and fast rule” (1/6) may make it even more difficult for entities to find their optimal Board mix.

In this connection, recommendations are better than prescriptions because they allow for the dynamics, audience and characteristics of each particular entity. There are reasonable grounds to build on the present Code’s recommendation for NEDs/INEDs to make up one-third of the Board. This may take the form of a detailed guideline outlining how the Board mix might change with the different circumstances of each entity, while adhering to the basic minima. Yet, if a prescription is a generally accepted way forward, one may opt to build on the present regulation recommending one-third of the directors to be NEDs/INEDs, starting from the more sensitive financial services industry.

#### ***4.3.9 Should the Code give NEDs/INEDs more priority in Board composition?***

The current Code recommendation referred to earlier has been standing for several years. Findings show that this does not reflect the current MLEs’ Board mix since most MLEs have a much higher proportion of NEDs/INEDs.

There is evident room to increase the minimum proportion of NEDs/INEDs recommended in the Code. In fact, some respondents held the view (5/31) that the Board should include a majority of NEDs/INEDs. However, in increasing such a minimum, care needs to be taken to avoid overdoing the issue and for the change to be implemented in steps over a number of years. Possibly, allowances may also be made for exceptions as long as these are justifiable.

As for the Code’s existing recommendation that the majority of NEDs are to be INEDs, the regulators probably need to ensure that the distinction between NEDs and INEDs is made much clearer than that present.

## **5. Conclusions**

This study concludes that INEDs are appreciated in Boards of MLEs as a result of pressures imposed by regulators and shareholders. However, Maltese family-owned entities seem to be slower in opening up to NEDs/INEDs. There are wide divergences in the Board mix amongst MLEs and these imply that no one optimal Board mix may be prescribed for all MLEs.

Indeed, the Board mix in the Maltese context is affected by both entity-specific and director-specific factors. One factor that results in onboarding more NEDs/INEDs is the entity's scope and complexity arising from the entity's size, age and new products or geographical areas. Another pertinent entity-specific factor in the Maltese context is CEO entrenchment resulting from CEO part share ownership, the entity's performance and the CEO also being an ED.

With regard to the director-specific factors, the study concludes that one director cannot be an expert in all areas and so entities composing the Board mix should include directors that collectively cover a wide range of skills and competencies. Moreover, locally residing NEDs/INEDs have a closer relationship with EDs than those residing abroad and so the former tend to be preferred over non-resident ones.

Whilst a specific standard Board mix may be recommended, imposing it as a prescription to be followed strictly by all MLEs may not be beneficial as this may prevent them from adapting the Board mix to suit their specific needs. Yet, prescribing a Board mix for a specific industry, such as for the banking or insurance industries, is not to be excluded. Moreover, this study concludes that the present Code recommendation for at least one-third of the Board to be NEDs/INEDs is too low and it is high time for such a proportion to be increased for these to become the Board majority. Additionally, the difference between NEDs and INEDs needs to be further clarified.

The presence of NEDs/INEDs in the boardroom only contributes to good CG if they actively carry out their duties rather than act as mere figureheads. Clearly, the quality aspects of NEDs/INEDs are important attributes that entities need to take into account if they are to achieve an effective mix. In particular, while active NEDs/INEDs do aid in the formulation of the needed strategy, the study concludes that they also have to extend their contribution towards guiding EDs and management in the execution of such strategy.

Furthermore, by asking the appropriate questions, NEDs/INEDs may place themselves in a better position to prevent and detect corporate irregularities and to enhance transparency in financial reporting. As for the implications of NEDs/INEDs having multiple commitments, these are not necessarily more negative than positive as such commitments may in fact be both a boon and a scourge to CG. Therefore, while the introduction of a limitation in the number of multiple commitments in the Code may not in itself be beneficial, both prospective NEDs/INEDs and the entities themselves may still play a crucial part in limiting as far as possible, if not completely eliminating, the negative implications of such multiple commitments.

A balanced Board mix is a major, yet only one, medicine prescribed to an entity for it to be helped in controlling its management from acting in its own interests and also having its Board acting in the best interests of the entity's shareholders. By understanding and analysing the various factors that affect the Board mix as well as

their ensuing implications on CG, entities will have a better chance to improve on their position to work towards more effective CG at Board level. Yet, of course, the Board mix in itself is never the panacea for good CG. After all, as stated by one respondent, “*Medicine may be helpful, and yet does not cure every underlying health problem*”.

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**Annex 1**  
**Interview Schedule**

**Section 1: The Board Mix**

Board characteristics of this company/group:  
Kindly indicate the number of directors that fall under each category.

Board size (see def 1): \_\_\_\_\_

Board mix (see def 2):	EDs		NEDs		INEDs	
Directors' age:	< 40 years	<input type="checkbox"/>	40 – 65 years	<input type="checkbox"/>	> 65 years	<input type="checkbox"/>
Directors' tenure:	< 3 years	<input type="checkbox"/>	3 – 5 years	<input type="checkbox"/>	> 5 years	<input type="checkbox"/>
Directors' gender:	Male	<input type="checkbox"/>	Female	<input type="checkbox"/>	Other	<input type="checkbox"/>
Directors' nationality:	Maltese	<input type="checkbox"/>	Other	<input type="checkbox"/>		<input type="checkbox"/>
Company's industry:	_____	<input type="checkbox"/>		<input type="checkbox"/>		<input type="checkbox"/>

1. a. Has the board mix of your company/ group changed in any way in the last 5 years?  
b. If yes, how?  
c. What do you believe were the drivers that induced such a change?

**Section 2: Factors affecting the Board Mix**

To what extent do you agree with the following statements? Kindly rate from 0 to 4 (with 0 being strongly disagree and 4 being strongly agree) as shown in Section A2, adding comments, if any.

2.	As companies enlarge, age or enter into new product or geographical lines, such companies tend to engage more INEDs/ NEDs.	
3.	Companies operating in volatile environments tend to engage more EDs.	
4.	Upon the imposition of strong controls on the CEO, the NEDs on a Board generally increase.	
5.	CEO duality necessitates more monitoring and so a higher proportion of INEDs/ NEDs.	
6.	Companies with ownership concentration reduce the proportion of INEDs/ NEDs because management monitoring lies more in the hands of the large shareholders.	
7.	A small board size (see def 1) tends to be composed of a lower proportion of INEDs/ NEDs than in the case of a large board.	
8.	Older directors are more risk averse than their younger counterparts and so decrease the risk of bankruptcy.	
9.	Younger directors are better in monitoring management.	
10.	As director tenure increases, INEDs'/ NEDs' monitoring effectiveness decreases.	
11.	INEDs/ NEDs residing in Malta usually have a closer relationship with EDs than those residing abroad.	
12.	An appropriate board mix needs to be supplemented by: a. board gender diversity. b. at least one director with knowledge of the company's key functions.	

13. Do you perceive an increase in a company's/ group's financial gearing as probably affecting the board mix? If yes, in what way?
14. Do you think that there is information asymmetry (*see def 3*) between EDs on one side and NEDs/ INEDs on the other side?
15. Do CEOs with shareholdings in their company/ group necessitate a change in the board mix towards more (i) INEDs (ii) NEDs?
16. a. Can company/ group performance influence the entrenchment of CEO at board level?  
b. If so, can such entrenchment also impact the board mix?
17. Does the board mix typically differ in larger or smaller boards? If yes, in what way?
18. In your view, are any of the following director-specific characteristics typically relevant to the composition of the board mix? If so, please specify.
  - a. Age
  - b. Tenure
  - c. Gender
  - d. Nationality
  - e. Number of multiple directorships held (*see def 4*)
  - f. Skills and competencies

**Section 3: The Contribution of Board Mix to Good CG**

19. In your opinion, how does the ratio between EDs, NEDs and INEDs affect (i) strategy formulation (*see def 5*) and (ii) strategy execution, if at all?
20. In your view, does onboarding more (i) INEDs (ii) NEDs aid in the prevention of corporate irregularity?
21. In what manner do (i) INEDs (ii) NEDs enhance transparency in financial reporting, if at all?
22. How is (i) INEDs' (ii) NEDs' contribution to good CG affected by their own multiple commitments?
23. How, if in any way, the answers to questions 20, 21 and 22 reflect the position in your company/ group?
24. Do you perceive Board mix as one of the prerequisites for a culture of openness and constructive dialogue among the directors?
25. a. In your opinion, which type of director, if any, needs to be in the majority?  
b. Can the extent of such majority as referred to in (a) be successfully prescribed or recommended by the regulatory framework?
26. What is your opinion about the recommendation of the Code of Principles of Good Corporate Governance for:
  - a. At least, one third of the Board to be NEDs?
  - b. The majority of such NEDs to be INEDs?
27. Other final remarks if any.



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### Section A1 - Definitions

1. **Board size:** The total number of directors on board, including EDs, independent and non-independent NEDs (Shakir 2008). A Board is classified as small if it has 5 directors or less, and as large if it has more than 5 directors.
2. **Board Mix:** The mix of executive directors (EDs), non-executive directors (NEDs) and independent NEDs (INEDs).
3. **Information asymmetry:** The gap between the information EDs and NEDs possess. Since EDs are involved in the day-to-day running of the company, they will be well versed about the company compared to NEDs.
4. **Multiple directorships:** A director holds three or more board seats (Fich, Shivdasani 2006).
5. **Strategy formulation:** The examination, ratification and evaluation of the proposed strategy (Schmidt, Brauer 2006).

### Section A2 – Scale

1. **Agreement scale** to be used for questions 2 - 12:

0	1	2	3	4
Strongly disagree	Disagree	Neutral	Agree	Strongly agree