SPECTRUM PUBLISHED: October, 2018

Does Gender Diversity on Corporate Boards Affect Firm Performance?

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ABSTRACT

This current literature review focuses on the diversity of members on the board of directors in corporations. By exploring contemporary literature in finance, this article seeks to understand the effects of board member gender diversity on firm financial performance. Firstly, diversity in board members is shown to have mixed results on firm performance. Secondly, heterogeneous board members' different life experiences and demographic characteristics lead them to solve problems and make decisions in various ways which could ultimately impact the financial performance of the firms they serve. Thirdly, gender diversity is a topic that has gained much attention on modern corporate boards. Appointing women to executive boards has proven to have effects on firm performance. In addition, governments around the world have taken action to promote gender equality by enacting gender quota legislation or by implementing codes of good governance. Furthermore, when appointed to the executive board, women face additional difficulties once in the boardroom. Lastly, the effects of gender diversity on firm performance are found to be mixed and varied.

1. Introduction

The board of directors serves as the focal point of control and administration within a corporation. Elected by a company's shareholders, corporate boards are responsible for strategic and financial decision making. The board of directors is tasked with approving annual financial statements, procuring financial resources and assuring the smooth transition of mergers and acquisitions. The primary duties of the board of directors; however, are monitoring and advising the Chief Executive Officer (CEO). In recent years, extensive research has been conducted on corporate board composition focusing on individual board member heterogeneity, which can be defined as the differences present among board members such as ethnicity, level of education, gender and main profession (Ferreira, 2011). This is in opposition to director homogeneity where executives

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Citation: Kaseram, D. (2018) Does Gender Diversity on Corporate Boards Affect Firm Performance?. *Spectrum* Issue No. 2

doi: 10.29173/spectrum44

Received: May. 14, 2018

Accepted: Aug. 24, 2018

Published: Oct. 25, 2018

share a single or multiple characteristics. Board member diversity has become a popular topic in modern firms, as appointing executives from various backgrounds may lead to added financial benefits and promotes equality in high-up positions within firms.

This literature review engages with the question of how diversity affects firm performance through the appointment of dissimilar executives to the board of directors in corporations. Furthermore, this article explores extant literature in academic finance journals to offer an overall understanding of diversity in a financial context since firm performance is a topic researched more in finance as opposed to other business sub-disciplines like management or marketing. Diversity of executives is especially relevant in finance as the addition of dissimilar board members may lead an executive team to make nontraditional strategic decisions that could end up affecting the financial output of the firm in a variety of ways. This paper touches on many aspects of diversity; however, it centers mainly on gender diversity, which is a pressing concern on contemporary corporate boards. This article is also of an interdisciplinary nature, examining questions intersecting business and gender studies.

The remainder of this article is as follows. Section 2 explores team member heterogeneity in contemporary finance literature, which delves into diversity's influence on firm financial and accounting performance. The pro and con arguments of corporate board diversity are presented in Section 3. In Section 4, gender heterogeneity on corporate boards is closely examined in finance literature. Section 5 discusses board gender quotas and codes of good governance that promote gender equalization on the board of directors. Section 6 provides contemporary anecdotal evidence of gender heterogeneity once inside the boardroom. This article concludes in Section 7 by summarizing the preceding diversity notions, addressing limitations, and providing an outlook on corporate board diversity research for the future.

2. Diversity and Firm Performance

Finance literature points to an important relationship between board diversity and firm financial and accounting performance. In fact, several studies document a positive correlation between diverse boards and firm market performance. Estélyi and Nisar (2016) find that boards with various national backgrounds prove to be more effective monitors of firm managers and encourage product as well as geographic diversification within their respective companies. These qualities displayed by foreign executives result in higher firm market value. Demographically diverse executive boards are also positively linked to increases in accounting measures of performance, such as ROA (return on assets) and ROI (return on investment) (Erhardt et al., 2003). Furthermore, gender-diverse boards are oftentimes associated with a less volatile stock price (García-Meca et al., 2015) which is ideal in attracting potential investors who prefer stability and steady growth. Although it is challenging to directly link diversity's attributes to improved organizational performance, these results are, for the most part, associations found throughout the board diversity literature.

Contemporary diversity literature also touches on the adverse effects of diverse practices on firm financial and accounting performance. Cimerova et al. (2016) conclude in their study that cultural diversity negatively impacts firm performance, because of the costs and frictions that naturally arise in culturally diverse groups. This is confirmed by the discovery of a negative relationship between cultural diversity and firm market value. Similarly, cultural diversity is found to negatively impact companies' ROA (Cimerova et al., 2016). Foreign directors have an additional negative effect on firm performance due to their geographic distance from the firm's physical place of operations (Cimerova et al., 2016). This naturally makes management and

doi: 10.29173/spectrum44

supervision more difficult for foreign directors who may reside far from the firm's headquarters or primary site of operations. Additionally, gender heterogeneity on corporate boards proves to increase portfolio risk, in a study carried out by Berger et al. (2014). However, this is inconsistent with the idea that women are more risk-averse than men in financial settings, as shown by Bellucci et al. (2010), who find female lending officers to be more risk-averse than their male counterparts in a bank setting. Moreover, shareholder value suffers on gender diverse boards on account of over-monitoring by female board members (Adams and Ferreira, 2009). Over-monitoring leads to director interference, which gives rise to a breakdown of communication between directors and managers, ultimately decreasing shareholder value.

3. Pros and Cons of Diversity

Even though the introduction of diversity in a corporate board setting is a relatively recent topic, it has already proven to both benefit and inhibit team operations. The following section examines the advantages and disadvantages that modern heterogeneous corporate boards encounter throughout their operations.

3.1 Pros of Diversity

Heterogeneous corporate board members are likely to have forged different relationships in numerous economic sectors over the course of their professional lives. Diverse boards are therefore able to rely on their wider pool of connections to secure financing, such as loans and lines of credit (Ferreira, 2011). On the contrary, homogeneous board members are more likely to have similar contacts in comparable industries (Kang et al, 2010). Furthermore, due to the influence of varied life and work experiences, diverse corporate board members' differing perspectives often result in heightened levels of creativity and innovation in group collaboration (Hsu and Wang, 2013). Homogeneous board members, on the other hand, may display similar cognitive patterns, such as groupthink (making irrational decisions as a group to promote conformity and reduce conflict), which impede innovative thinking, thus delaying the problem-solving process (Kamalnath, 2017). Finally, companies with diverse corporate boards are often looked upon favorably by shareholders. In a fast-growing multicultural setting, many shareholders themselves are diverse and relate better to a board of directors that represents its shareholders in multiple aspects (Cannella Jr. and Hillman, 2007). Additionally, firms with heterogeneous corporate boards may also be viewed approvingly by the public, media, and government (Ferreira, 2011).

3.2 Cons of Diversity

Firstly, an abundance of diversity can lead to internal conflict of viewpoints on a board of directors (Hsu and Wang, 2013). The differing aspects among board members (demographic, educational, functional etc.) all influence their decision-making and problem-solving practices, which may clash with the ways in which other members find solutions to problems the company is facing. This will likely lead to disunity within the group and to a lack of group cohesiveness (Saz-Carranza, 2012). Secondly, diverse groups may unofficially divide themselves into sub-groups in which the members find more similarities with one another, a natural tendency according to Hou and Smith (2015). The authors go on to state that this in-group favoritism typically leads to the reduction or complete absence of communication, coordination, and cooperation with either the whole group or dissimilar sub-groups, which can eventually lead to poor group performance. Lastly, female directors may only be hired to fulfill a mandatory gender quota and not for their competencies, a practice known as tokenism. Consequently, firms may incur costs due to the inexperience of female directors, as was the result in Norwegian firms which were fully obligated to adhere to a 40% gender quota as of January 2008 (Ahern and Dittmar, 2012).

doi: 10.29173/spectrum44

4. Gender Heterogeneity and Firm Performance

The appointment of women directors to corporate boards is becoming more and more common. In the past, executive boards were nearly exclusively male-dominated since women occupied a subaltern position in western society. Female responsibilities included household chores and child-rearing, whereas men were the breadwinners, or those who worked outside the home. The Sexual Revolution of the 1970s was a major social movement that contributed to the alteration of these traditional gender roles, which empowered women to pursue education and enter into the workforce (Nino, 2006). Since then, women have been steadily climbing the corporate ladder, eventually obtaining executive board positions. In 2016, women held approximately 27.3% of directorships in Fortune 500 companies (Zillman, 2017). There exists an active gender imbalance on corporate boards since men still hold most of the higher-up positions. An extreme example of this inequality can be found on Moroccan corporate boards where 100% of board members are men (Aguilera et al., 2015).

Gender-diverse boards experience different decision-making processes than homogeneous or male-dominated boards because of the varying backgrounds, perspectives, and personalities that both men and women present. Consequently, diversity has an impact on financial outcomes due to the decisions that are made by the heterogeneous board of directors.

Firm value is the ratio of firms' market value of assets divided by their replacement value. This is an important financial tool used in assessing a firm's stock value. Opinions of the effects of gender on firm value are varied. García-Meca et al. (2015) find that having women on the board of directors positively impacts firm value in the banking sector. Australian evidence posits that if two firms are similar in every aspect except gender heterogeneity, the company with the gender-diverse corporate board will see higher firm value on average (Faff and Nguyen, 2007). A potential explanation for the increase in firm value may be that diverse groups have an overall better understanding of the marketplace which itself is diverse. Therefore, heterogeneous boards make better strategic decisions because their members can contribute market-specific information that the rest of the directors would otherwise not know. Additionally, women are observed to be associated with a higher market value than men (Faff and Nguyen, 2007). A potential reason for this may be that women are more engaged in the operations of the firm and actively monitor managerial behavior to ensure the firm functions efficiently (Bel-Oms et al., 2016).

Alternatively, firm value is negatively impacted in Malaysian firms with female directors (Abdullah et al., 2016), presumably because women in powerful positions are poorly regarded in traditionalist societies like Malaysia. This result is in accordance with the "glass cliff" theory, which posits that female leadership may be to blame for poor firm performance instead of any situational or contextual variables. As a result, a negative relationship between women directors and stock-based measures of firm performance is observed in Malaysian firms. Other authors, such as Carter et al. (2010), find no significant relationship between firm value and gender diversity in U.S. firms. Thus, gender heterogeneity in U.S. boards may or may not be a factor affecting financial performance.

Accounting ratios are also affected by the presence of women on the board of directors. Liu et al. (2014) identify a positive relationship between female directors and the ROA, as well as the ROS (return on sales) of Chinese firms. Furthermore, boards with three or more female members have a stronger impact than boards with only one or two women. Similar results are found by Sanan (2016), who documents that the addition of women board members leads to a

doi: 10.29173/spectrum44

significant increase in the ROA of Indian firms. In the long term, positive relationships are shown to exist between the percentage of women directors on a board and stock price growth and growth in earnings per share (Cycyota et al., 2007). These positive relations further support the popularity of having women on corporate boards due to the increased firm performance.

The announcement of adding a woman board member generates negative market reactions (James and Lee, 2007). Shareholders are understandably sensitive to changes in leadership and tend to react negatively when an incoming female CEO is announced (James and Lee, 2007). This is likely because female CEO appointments are uncommon and shareholders assume women are not equipped with the necessary leadership tools (e.g., assertiveness) to lead a company. Gender stereotypes dictate that men are more associated with leadership roles because they occupy most of the leadership positions, whereas women are identified with more feminine roles (Carlie and Eagly, 2002). Moreover, Farrell and Hersch (2005) fail to detect any market reaction to the addition of women to corporate boards. Perhaps future research will be able to provide a clearer conclusion about the market reaction to the addition of a female board member.

The relationship between female board representation and risk-taking in a firm is unclear. As mentioned previously, gender diversity has been shown to increase portfolio risk (Berger et al., 2014). However, other research posits that boards with greater gender heterogeneity are associated with less variability in stock return (Lenard et al., 2014). Finally, Gonzalez et al. (2016) find that boards with higher female representation are no more or less risky than a male-dominated board. These different conclusions can most likely be explained by the uniqueness of each risk-taking situation.

5. Promotion of Gender Equality on Corporate Boards

5.1 Mandatory Gender Quotas

The board of directors has long been witness to considerable gender homogeneity, more precisely, an extensive male presence. However, 11 countries now enforce gender quotas, demanding that either a percentage, or a certain number of female directors hold positions on the corporate boards of publicly-traded and state-owned enterprises. The first country to address gender imbalance on corporate boards through the enactment of legislation was Norway in 2003, stipulating that boards were to observe a 40% gender quota (Teigen, 2012). Firms were to be fully compliant by 2008, and those that failed to adhere to the quota were to face harsh penalties, including the possible dissolution of the firm. Post quota reform diversity literature shows that gender-equalization legislation has had diverse effects on publicly-listed firms, such as a negative impact on firm performance (Ahern and Dittmar, 2012), and an increase on returns for firms with low information symmetry (Dale-Olsen et al., 2013). Alternatively, Dale-Olsen et al. (2013) conclude that the quota reform only negligibly affected Norwegian firms' performance. The Norwegian quota reform also set the stage for the enactment of gender quota legislation, first in Europe (Eckbo et al., 2016), and then across the globe into the Middle East and Asia. Since then, countries such as Belgium, France, Iceland, Italy, and Spain have all adopted a form of gender quota legislation as well (Smith, 2014).

5.2 Codes of Good Governance

As of the writing of this paper, 15 countries throughout the world have elected to apply soft-law (non-binding regulation within codes of good governance principles), as opposed to hard-law (statutory impositions with penalties for violation) policies (Aguilera et al., 2015) to promote gender

doi: 10.29173/spectrum44

equalization on publicly-traded and state-owned company boards. Soft-law policies are far less restrictive and punitive than hard-law policies, and often incorporate a "comply or explain" regulation, in which firms must either accept women directors onto their boards or disclose the reasons behind the absence of female representation. Aguilera et al. (2015) find that soft-law practices function more effectively in countries such as the UK, where the gender-equalization norm is universally accepted and social peer-pressure sufficiently ensures its enforcement. The UK government has commissioned independent initial and follow-up reports (Aguilera et al., 2015) about the corporate board structure of the FTSE 150 companies listed on the London Stock Exchange since 1992. The Higgs Review (2003) and Tyson Review (2003) both favor gender diversity on boards, contending that it enhances effectiveness and closes the productivity gap between the UK and its major competitors (Fagan et al., 2012). In 2011, the Davies Review drew up recommendations for the FTSE 100 and 350 firms with respect to gender diversity on their corporate boards. Such suggestions include the publication of the number of women on company boards, the establishment of gender policies, and the diffusion of progress made with firms' diversity efforts (Fagan et al., 2012). Fagan et al. (2012) also find that boards with women directors make the largest pre-tax profits and have a higher ranking on the FTSE 150, therefore enjoying greater market capitalization. In sum, the implementation of codes of good governance suggests positive results for UK companies.

6. Gender Diversity inside the Boardroom

Women are often confronted with the proverbial "glass ceiling" when climbing the corporate ladder. However, when women are appointed to the board of directors, they face certain challenges that male board members do not. In interviews conducted by Bell and Groysberg (2013) in the Harvard Business Review, women find themselves to have to be more qualified than men to be considered for directorships. Once admitted to the board, female directors often feel they are not heard as intently as their male counterparts, because they are on average younger and less experienced. Therefore, female contributions may be viewed as less valuable by other board members. Female directors are also not invited as often to social events and are more often disregarded because they are not part of the "old boys' network," a male support system often exploited to help men from similar backgrounds move into higher positions. This is especially discouraging for women given the personal costs that they often incur to reach the top. Finally, women directors are often unmarried or divorced and have no children (Winn, 2004). Those with families sometimes do not receive assignments that require travel due to their family commitments. Even though efforts are being made to include women on corporate boards, there is still much work to be done before they are completely equal with male directors.

7. Conclusion

Diversity of corporate board executives has been shown to affect firm performance, both positively and negatively. Extant finance literature illustrates that having board members from a variety of demographic backgrounds can impact firm performance by increasing or decreasing financial indicators such as market value and ROA. Moreover, scholars have found different results, since all companies operate differently, and diversity's effects may not necessarily have the same influence in each and every firm. Furthermore, appointing heterogeneous directors proves to have advantages and disadvantages with regard to the inner-workings of the executive team. The differences in problem-solving and decision-making that dissimilar board members present lead

doi: 10.29173/spectrum44

corporate boards to make crucial decisions that affect the financial output of the firm. As is the case with other forms of diversity, gender diversity produces mixed results in firm performance. Many of the effects that women have on financial output can be attributed to different professional qualities they possess, such as the tendency to monitor firm operations more closely. As a fairness argument for diversity, nations around the world have started to enact legislation or implement codes of good governance to promote equality on corporate boards within their publicly-traded and state-owned firms. In modern times, gender equality has become a topic addressed not only by government, but also by western society in general. Again, these measures generate mixed results in terms of firm performance as heterogeneity affects companies in different ways. As the legislation and codes of good governance have only recently been implemented, it is not yet possible to determine any long-lasting effects of enforced diversity measures. In addition, contemporary evidence of board member dissimilarity shows that even though strides are being made to diversify corporate boards, modern boards are still far from achieving complete board member heterogeneity and equality. Women are still faced with many obstacles to overcome; that is to say, their struggle to reach the top does not end with being appointed to the executive team. They still face difficulties once inside the boardroom, because male directors may not necessarily see a female board member as their equal.

I was confronted with certain limitations while composing this literature review. Firstly, I was unable to execute a statistical analysis to pinpoint the effects of gender diversity on firm performance. Secondly, I was for the most part only able to draw on finance literature pertaining to firm financial performance. Another possibility would have been to analyze executive team diversity in other aspects of business, such as management and international business. This would have provided a more well-rounded and global understanding of executive team member heterogeneity. Lastly, I hope that future research will advance team member heterogeneity in multiple disciplines, and accurately identify the financial impact that diverse board members have on the firms they serve.

Acknowledgments

I would like to thank Dr. Sadok El Ghoul, my supervisor, for his continuing guidance and encouragement without which I would not have been able to complete this study. I would also like to thank the Bureau de la recherche for its generous and on-going support throughout all stages of this project.

doi: 10.29173/spectrum44

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