



Theoretical foundations of gender diversity and financial performance

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Abstract

In the last two decades gender diversity has received much attention in academic research. Gender diversity on boards is a larger ethical issue and is grounded in providing equal opportunities leading to enhanced social welfare. Generally, it has been observed that globally women underrepresent the boards of companies. Women on boards might be able to bring in different perspectives due to their inherent distinctive differences with men. We examine the various theories on gender diversity which have come about in the recent years on explaining the role of women directors on boards of a company. We also look at the various factors which have an impact on gender diversity and do a review of prominent research studies highlighting them. Many countries have enacted mandatory appointment of female directors on boards. We examine whether such legislation necessarily brings in improvement in corporate performance or is just a mere tokenism. Finally, we review research whose findings show that gender diversity has a positive relationship with financial performance of firms.

Keywords: Gender diversity, financial performance, boards/board of directors, women directors, theories (or theoretical foundations)

Introduction

Historically, it has been seen that in India typically the control and power has always been found to be bestowed on men and the role of women in the society has been restricted to taking care of the home (Ismail and Manaf, 2016) ^[28]. In such a scenario there would be resentments on giving power to the women by appointing them on the crucial decision-making and strategic role as a director on the board of a company. As they might be viewed as to not to possess the required characteristics and abilities for the success of companies. Though they might have the required educational qualifications and expertise for the role. Directors have a crucial and significant role to play as they position the companies strategically to survive competition, bring in new technologies, train workforce for achieving effectiveness and efficiency in business operations, mitigate various risks, launch new products, enter new markets, capitalize on various opportunities that come on the way for future growth and keeping the various stakeholders happy. The directors essentially bring in four types of benefits to a company *viz.* they bring in expertise in the form of guidance and advice; they provide access to purveying of information between corporates and its environment; a favoured access to resources and legitimacy (Pfeffer and Salancik, 2003) ^[40].

In the case of Indian listed companies, one sees a drastic increase in number of women directors during eight-year period 2013-2022. The number improved from 6% in 2013 to 18% in 2022 as per a report by Ernst and Young India (EY India, 2022) ^[15]. This has been only possible due to the changes in the Indian companies Act 2013 for providing for compulsory quotas for women to be fairly represented on boards. European Parliament passed a legislation in 2022 that any company employing more than 250 people must appoint a minimum of 40% of women non-executive directors by the year 2026. Similarly, Japan where the boards are meagerly represented by only 18% by women directors are looking to get at least 30% by the year 2030 (The Economist, March 24, 2024) ^[50]. Therefore, it is

expected that where ever there is gender diversity people would bring in different perspectives and would help in decision making. Men and women due to their inherent characteristics have different perspectives with regards to looking at opportunities and have different risk-taking appetite. Tleubayev, Bobojonov, Gagalyuk, and Glauben (2020) ^[49] show that perceptions about risk and opportunity are different between the two. It is generally believed that the characteristics which are necessary to be successful in leadership roles like being assertive, tough and the ability to be an effective leader are normally perceived to be the traits of men rather than females (Heilman, Block, Martell, and Simon, 1989) ^[25].

Diversity on boards is an area which has witnessed a phenomenal attention in the last couple of decades. Globally, it has been the bastion of men to occupy the major leadership roles in management and then to also serve on the boards of such companies. However, the situation is not the same anymore and we see an increased representation of women in important leadership positions and on the board of directors too. There is a phenomenal support provided by extensive research to show that a positive impact is made by women directors in the working of a company and they are more inclined towards social corporate responsibility than directors who are men (Shaukat, Qiu and Trojanowski, 2016) ^[46]. It is observed that women directors can vastly improve the existing corporate governance mechanisms in companies and are inclined towards higher dividend payouts (Chen, Leung, and Goergen, 2017). Results of the research study by Adams and Ferreira, (2009) ^[3] show that women are more diligent in performing their monitoring functions and put in more efforts to confirm to accountability Gul, Srinidhi, and Ng (2011) ^[23].

Women are generally more patient as compared to men and are thus able to enhance the collective ability of the directors in strategic decision making (Amran, Lee and Devi., 2014) ^[8]. They have also been found to be better in negotiating deals in the case of acquisitions and are more

likely to pay less premiums (Levi, Li, and Zhang, 2014)^[33]. Faccio, Marchica, and Mura, (2016)^[16] show that women directors are less prone to risky financing and investment choices. Studies show that they are more honest, they possess better multi-tasking skills; are more risk averse and generally have better educational qualifications. The study by Miller and Triana (2009)^[37] took inputs from the signaling theory and behavioural theory of a firm to find a positive connection of a racially diversified board and reputation of such companies and their ability to innovate. They document that both reputation and ability to innovate in a way mediate relationship between racial diversity of the board of directors and the performance of companies. Further, they observe a gender diversity to be positively related to the corporate's ability to innovate. If the performance of companies is measured by the return on assets and return on sales metrics then they have been found to significantly improve it (Liu, Wei, and Xie, 2014)^[34]. The present research's contribution is that it enhances our understanding of theories which elucidate the influence of female representation on the boards of companies; examines the mandatory quotas for their inclusion on boards across countries and the result of a gender diversified board on companies' performance.

Our paper is organized as follows. We discuss the underpinnings of various theories suggested in the literature which are focused around gender diversity in section 2. In section 3, we look at the various legislations which have been enacted in various countries for ensuring mandatory quota requirements for women directors. In section 4, we review the research which has been conducted recently to determine the effect of appointment of women directors on the performance of companies. We give our conclusions in section 4.

Theories

We briefly discuss the various theories postulated in the literature which provide direction to the impact women may have on the boards

1. Agency theory

A public limited company's major characteristic is that people who own the company known as the principal are different from people who manage known as the managers. However, this creates a principal-agent problem (Jensen and Meckling, 1976). In a principal-agent relationship where an agent works on the instructions of another, a conflict of interest between the two takes place. This conflict results into agency costs. The managers have their own self-interests (higher salaries, better perquisites, better working conditions, more power) and therefore, if they are not constant and continuously monitored, they may not always maximize the wealth for the owners of companies i.e. the shareholders (Agrawal and Knoeber, 1996)^[5]. The composition of board has seen phenomenal academic interest from the point of view of their independence and the performance of companies in the eighties and the nineties (Agrawal and Knoeber, 1996)^[5]. Ownership structure of corporates is a significant corporate governance mechanism which could help in reducing agency costs (Jensen and Meckling, 1976)^[29]. The vast existing literature has largely been focused around the stipulations of agency theory in looking at the influence a gender diversified board has on the decision making of companies. Some prominent studies have been by Nguyen, Locke and Reddy (2015)^[38, 42]

Ararat, Aksu, and Tansel Cetin, (2015)^[9] Chapple and Humphrey, (2014)^[13] Francoeur, Labelle, and Sinclair-Desgagné, (2008)^[19] and Carter, Simkins, and Simpson, (2003)^[11].

Agency theory brings about the likelihood of conflicts of interests between the managers of a firm and its shareholders. This becomes more relevant in India, where there the ownership in companies is controlled by various members of a family. Most of the listed companies in India are family controlled. Therefore, the promoters or insiders who have a substantial stake in the companies promoted by them could in a way both reduce and enhance the agency conflicts. They might be able to align the decisions taken by the managers with the interests of the shareholders by focusing on liquidity for attaining flexibility in their operations. Conversely, if there is concentrated ownership, then insiders could use the large cash holdings for their own personal interests thus leading to appropriation of assets of the firms. It is in this context that the existing literature amply demonstrates that women in top positions in firms are less inclined to design risky policies as compared to men (Faccio, Marchica, and Mura, 2016)^[16].

Since the people who manage the companies- the managers have more information compared to the providers of capital- the shareholders, there is a phenomenal information asymmetry between the two. The kind and quantum of information shared by the managers with the outside world is decided by the managers. It is critical that the objectives of the owners and the management of companies is the same. Therefore, the board of directors have an important role to play in conveying significant information (information signalling) and to efficiently monitor the actions of the executives (Fama and Jensen, 1983)^[17].

It is but natural, that diversity of the board has received much consideration in academic research due to the perception that there are fundamental differences in the primary values of women directors (Adams and Funk, 2012). A study by Ain, Yuan, Javaid, Usman, and Haris, (2020)^[6] looked at whether a gender diversified board results in the reduction of agency costs by taking a sample of Chinese listed firms during a recent period 2004-2017. The results of their study show that presence of women directors in corporate board reduces agency costs. They also report that boards which are gender diversified are far more effective than state run organisations where generally issues related to agency are worse. Women directors are also seen to be better monitors. They conclude that mere tokens does not help, but it requires a good number of females as directors in order to reduce costs associated with agency. Their findings support the agency theory framework and support that females on the boards strengthen the corporate governance mechanism and results in economic benefits. Rixom, Jackson, and Rixom (2022)^[43] have also suggested that mere woman presence on the board as a token does not provide any value but in effect their inputs would be harmful to the companies.

2. Resource dependence theory

Another important and influential theory known as the Resource Dependence Theory (RDT) postulates that if the board of a company is diversified then it would provide the companies with far better resources and therefore would have more chances of positive performance (Abdullah and Valentine, 2009)^[2]. RDT posits that if women are included

on the boards of companies, it would represent a better assortment of expertise and resources as compared to boards which have only men. This could result in enhancing the profitability of companies. This theory has its origin in organization and strategy. It perceives a company to be a system which is influenced by happenings taking place outside its structure and in turn also affects its external environment through its decisions and actions. Substantial research in corporate governance related to boards indicate that RDT to be a good context to look at the issues related to the boards and their functioning.

It is argued that a board which is diversified signifies a valued set of resources which might help to attain a firm's objectives and goals (Hillman, Shropshire, and Cannella (2007) ^[26]). Basic tenet of RDT is that the important link between the companies and the various kinds of stakeholders is provided by the board of directors. In effect it is they who bring legality to the various stakeholders or groups in a society. It is also pertinent to note that including females on boards in a way provides legitimacy to the external environment with regards to the values of a corporate on diversity. RDT posits that it is beneficial for the companies which are a part of a supply chain to rely on each other and should cooperate to achieve better advances in their performance over a long period of time rather than striving for gains in the short period at the cost of other firms. Therefore, RDT posits that organizations rely on other firms for their requirement of resources to achieve and maintain growth and in the same way other forms are dependent on them to maintain their own growth (Pfeffer and Salancik, 1978). Thus, RDT essentially looks at the power structures. It offers to provide a framework as to how the managers of a company work with groups who have considerable power over the resources they require for sustenance since they control such resources. Thus, we see that the basic premise of RDT is that firms on their own are not self-sufficient with regards to resources which are crucial for their survival and must rely on others to compete (Heide, 1994) ^[24]. It is in this sense that Hillman, Shropshire, and Cannella (2007) ^[1] extend RDT to propose that a board of directors which is appropriately diversified signifies a valued set of resources which could be useful in attaining economic gains. It is important to see how the RDT framework could be useful to promote a gender diversified board, as it could facilitate connections with significant groups in the external environment which could help in obtaining better talent. Diversified boards could be useful in better monitoring of the activities of the managers and result in effective decision making also at the board level (Reddy and Jadhav, 2019) ^[42]. Some prominent research work which has used resource dependence theory as a framework to study the effect of gender diversity on economic benefits have been conducted by Reguera-Alvarado, de Fuentes, and Laffarga, (2017) ^[44] Isidro and Sobral, (2015) ^[27].

García-Meca, Garcia-Sanchez, and Martínez-Ferrero, (2015) ^[22] examined both the impact of women representation and diversification due to nationality on the boards on the performance of 159 banks taken from nine counties in 2004-2010. Their findings seem to suggest an improvement in performance of banks due to a gender diversified board. However, nationality appears to restrict it. Their results also suggest that in case of countries with weak regulatory environment and comparatively weaker protection for

investors, the diversification on the boards does not influence the performance that much. Study by Lückérath-Rovers, (2013) ^[36] examines the performance of a sample of 99 companies from Netherlands which included both men on boards of companies as well as without female representation on the boards. The findings of their research work seem to indicate when women are present on the boards then the performance of the companies is better than the companies where female directors are not there. Carter, D'Souza, Simkins, and Simpson, (2010) ^[10] looked at matters related to diversity based on gender and other marginalized groups as directors on boards of firms. Their sample of study consisted of companies based in the United States. Their results do not show any noteworthy connection between the diversification of the board with regards to gender or ethical background.

3. Critical mass theory

Considering the significance of a gender diversified board and poor representation of women on the boards, the European Council in 2022 passed an order to have requisite quotas on boards of certain companies to increase women participation. Existing research in this area however documents that a mere increase in the number of females on the boards is not the answer to the problem and could hardly be the solution. As it is observed that though this could bring in equality and could be termed as ethical but an increase may not necessarily result in improving performance of the firms (Lefley and Janeček, (2024) ^[32]). Critical mass theory stipulates that to have a positive impact of women directors there should be a minimum threshold of female directors to improve the dynamic forces at work on the boards and enhancement in the corporate governance mechanism. Lefley and Janeček, (2024) ^[32] examined this issue extensively grounding their work in Critical Mass Theory. The findings of their study suggest that from the perspective of critical mass, if the composition of the board is not tilted towards independent women directors than the advantages which one wants to achieve through a gender diversified board may not be possible. Since then, only these women directors could work in unison and could take collective decisions and voice their concerns. These, marginal women can be then firmer and can become more assertive in the common viewpoints they share (Fitzsimmons, 2012) ^[18]. He shows the reasons for non-achievement of critical. Thus, from a critical mass perspective, the existing research documents that compulsory quotas for women on boards are a much quicker way to improve the number of females on the boards of companies (Chandler, 2018). Joecks, Pull, and Vetter, (2013) ^[30], provide a thought-provoking argument when they say in their work, we are not in a position to judge whether the established link between board diversity and performance would also exist in a system where women were appointed only because of the quota and not because of the knowledge and expertise they bring into the board.

Legislations around the world

India has made it obligatory for its biggest five hundred companies based on their market capitalization and are listed on stock exchanges to appoint a minimum of one female director. The last date to do so was set as 1st April, 2019. Another stipulation that SEBI has made is that the biggest one thousand companies must employ a female

director who would be independent by 1st April, 2020. New Companies Act of 2013 has also made it mandatory for all companies to appoint a woman director in case of a new company inside six months of their incorporation. All other companies must do so within a year. A report by EY India, (2022) shows that these mandatory stipulations for a better gender diversified boards for the biggest companies in India have been very effective and have led to a significant improvement in the number of woman representation on boards of companies. Looking at advantage's women bring on the board and to ensure their fair representation, numerous countries have passed statutory regulations to make it mandatory for appointment of women directors. Italy, Malaysia, Norway, United States and Singapore have ensured this by-passing National Companies Act in their countries respectively (Pastore, Tommaso, and Ricciardi, 2017; Ismail and Manaf, 2016; Kang, Ding, and Charoenwong, 2010)^[28, 31, 39]. A report by EY India (2022) shows that many other countries, for example Finland, Spain, France, Iceland, Kenya, Israel, Germany, Italy, Belgium, Austria and Portugal have also made a gender diversified board mandatory by having quotas for females. These countries require a minimum of 40% of the board to be women directors. It is also desired by the governments of many countries like England, Australia, and Sweden to have a proper mix of women as well as men on the boards of listed firms. It has been found that in 2019, France had the highest female representation on boards with 44.3% which is followed by Sweden at 39.6% while Norway lags at 39.2%, for India it was 15.9% gradually increasing from 12.8% in 2016. Research study by Kang, Ding, and Charoenwong, (2010)^[31] show that though number of females on the boards have improved throughout the world but it has rather increased at a very slow pace.

Impact of gender diversified board on financial performance

Much research work has been carried out to look at gender diversity in relation to boards of companies. Many reasons have been put forward to show that financial performance of firms improves, if the board is gender diversified. One of the justifications put forward is that a diversified board might be better able to improve its performance because of better understanding of the markets with regards to the products and their usage and segmentation which exists in the markets. It could also ensure better advancements in innovation and creativity resulting in enhancing operational performance. A diversified board may enhance and improve a company's image resulting in increased turnover (Solakoglu, and Demir, (2016)^[48] Pucheta-Martínez, and Bel-Oms, (2016)^[41].

Vast amount of research has focused on determining whether women directors are able to improve the performance of companies or not. However, the findings indicate mixed results. Numerous studies have found that a gender diversified board improves the financial performance of corporates. Some of the studies which have been conducted recently are by Rubino, Tenuta, and Cambrea, (2021)^[45] whose results show that there is a noteworthy improvement in performance of companies, if it is measured in terms of return on assets (ROA) in case of companies with women directors. Chijoke-Mgbame, Boateng, and Mgbame, (2020)^[14] examined the power of women on the boards and their number on important committees like the

audit committee on the financial performance in the African context, where the corporate governance mechanisms are not that strong. Their results for a sample of 77 observations indicate that female directors do have a significant and important impact on the performance of companies. They also observe that it is very important to have a good number of women directors if one wants to see some major improvement since a critical mass is essential. With a large sample of 400 Nigerian firms, Alhaji Sani, Abubakar, Aliyu, and Sule, (2019)^[7] also looked at the economic outcomes associated with a diversified board. The research was conducted during 2012-2016. The findings of their research work suggest that women representation affected the financial performance of their companies. Thus, once again their results support the belief that gender diversity results in improvement in performance of firms in line with resource dependence theory.

Abdelzaher and Abdelzaher, (2019)^[1] looked at a sample of Egyptian companies. Egypt has a unique setting of restriction on working women. Their sample size was 114 non-financial listed companies. Their period of study was only one year i.e. 2013. They controlled for size of the board, the industry in which the firms operated and duality of the Chief Executive Officer (CEO). Findings show a connection among the share of women on boards and firms' value (Return on Equity (ROE)). Alternatively, they also did a robustness check by taking Tobin's Q as a measure of performance. Their results also suggest that the nature of the industry also affects the performance. The findings have important implications for the management of companies to train more women for top executive leadership roles in companies and on the boards of companies. Low, Roberts, and Whiting, (2015)^[35] examined the listed companies in some of the developed countries in south east Asia. These countries included Malaysia, South Korea, Singapore and Hong Kong. They also report that when there is an increase in women directors then there is a significant positive change in the companies' performance. It is interesting to know that they can show in their study that the position of a company towards women who work does moderate this relationship. Findings of the research by Fredericks (2014)^[20] for U.S companies suggest that after the appointment of women on boards substantial returns are generated up to five years. Their research looked at response of the market to appointment of first woman who is appointed as a director in case of Fortune 250 companies. They used the Fama-French three factor model and found that abnormal returns are generated by the market on the announcement of the first woman director by a company. They also observed that on the announcement day, the abnormal return was zero but the returns over a long period of five years were positively significant. Thus, their findings back the notion of female directors adding value to firms and therefore it is pertinent that females should be appropriately represented in leadership positions in the industry.

In an extensive study carried out by Carter, Simkins, and Simpson, (2003)^[11] for examining the association among diversity of board members and its effect on the value of the firm for companies. Their sample comprised the companies included in the Fortune 1000 list. By board diversity they meant the number of women, number of African Americans, number of Asians, and number of Hispanics which were represented on the boards of companies. They used Tobin's Q to measure the firm value. The significance of this

research can be gauged from the fact that it was the first research of its kind to provide empirical evidence to show whether a diversified board is related to enhancement in financial performance of the firms. Their control variables included size of the firm, the industry in which the firm operated and included some measures for corporate governance. The findings of their study indicate significant positive relationships between the proportion of female representation and representation by other minority groups and the value of corporates. Another significant finding was that as the proportion of females and other factions increased, the size of the companies and the size of the boards also increased but it decreased with the increase in proportion of the insiders.

Findings of Singh, Vinnicombe, and Johnson, (2001) for United Kingdom (UK) show that firms which have many women directors have better performance. Their results are based on a survey of women directors of companies included in the FTSE 100. They found that only 61 % of the biggest companies in the UK had women directors in the year 2002 which had declined from the earlier figure of 64% in the year 1999. One startling fact which was observed was that female in top leadership roles only accounted for 3% of executive directorships and in totality there were only fifteen women executive directors. Arguments which are generally given are that women lack ambition and drive, they are less experienced and have poor commitment. Research has shown these arguments to be baseless. On the other hand, the findings of a few studies by Adams, and Ferreira, (2009) ^[3] and by Adusei, Akomea, and Poku, (2017) ^[4] indicate that financial performance of firms is inversely related to women directors. Thus, we observe that majority of the studies are focused on determining the impact of women representation in improving the corporate governance systems and enhancing the operational and financial performance of companies.

Conclusion

In this paper we reviewed the research work which has focused on various theories related to gender diversity on boards. Specifically, we examined the agency theory, the resource dependence theory and the critical mass theory. We also looked at the various legislations which have been put forward in countries for mandatorily require quotas for appointing a requisite number of females on companies' boards. Lastly, we examined the research work carried out in examining the relationship between appointment of women on boards and the improvement in the financial performance of companies.

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