Corporate Governance, Board Gender Diversity And Corporate Performance: A Critical Review Of Literature

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Abstract

This paper aims to critically review the existing literature on the relationship between the Corporate Governance aspect of board gender diversity, and its influence on corporate performance. This review specifically evaluates theoretical and empirical literature related to board gender diversity and corporate performance with an aim of establishing areas of gaps for further research. In particular the paper identifies some of the important theoretical, operational, measurement, contextual and methodological drawbacks in previous researches and literature that restrict generalization of results to particular contexts, sectors and larger populations. Additionally, several research avenues are proposed for in-depth understanding of the relationship between board gender diversity and corporate performance. Finally, the implication of the study on policy, theory and practice are discussed.

Keywords: Corporate governance, performance, board gender diversity and Kenya

Corporate Governance and Board Gender Diversity

The concept of corporate governance has continued to elicit lots of scholarly debate owing to multi-dimensionality and multi-disciplinary definitions .Among economists and legal scholars, corporate governance is defined as defense of shareholders' interests (Tirole, 2001) Alternately, Shleifer & Vishny, (1997) defined corporate governance as the process though which suppliers of finance to corporations gain assurance of return on their investment. Hill & Jones (2001) assert that corporate governance from a managerial perspective refers to the controls used to ensure that managers' actions are consistent with the interest of key constituent shareholders. From these definitions, corporate governance generally depicts the process which determines the purpose of the organization (whom exists to serve) and how these purposes and priorities are decided. Corporate governance within its core structure is thus concerned with the organizational functionality as well as the distribution of power among its various stakeholders(Johnson and Scholes, 1997). Evidently, the definition of corporate governance seems to vary along one's view of the world(Shahin and Zairi, 2007). In spite of these variations, scholars seem to have build consensus and generally settled on three main components of corporate governance(Mazudmer, 2013).The first component is outlined as the corporate governance philosophy which underpins the goal for which the corporation is governed. The second component comprises the roles and relationships among a company's management, its board, its shareholders and other stakeholders. The third and last component comprises the firm's domicile regulatory and market mechanisms.

Alternately, a cross section of researchers have also measured corporate governance using board of directors, ownership structure, market mechanisms and the legal system. From the foregoing, corporate governance is presented as multidimensional variable where the board is distinctly a key construct. Berle & Means(1932) sought to explain the role of the board of directors by suggesting that separation of ownership and control of capital in publicly held companies precipitates conflicts of interest between principals(Board of directors) and agents. The notion that when ownership and control are separated, principals (Board of directors) employ governance mechanisms to reduce agency costs is well documented in literature. (Jensen and Meckling, 1976) aver that the board of directors which is a sub-construct of corporate governance is put in place to safeguard the interests of principals from agents bent on extracting private benefits from the organization.

Board of directors is depicted and conceptualized variously in literature including the number of independent directors, the tenure of boards, the size of the board and board gender diversity. Gender diversity as an aspect of board composition/diversity is thus an indicator of corporate governance. Dutta & Bose (2006) present gender diversity in the boardroom as the presence of women on the board of directors and term it an important aspect of board diversity. Corporate boardrooms have not realized gender diversity yet this scenario is replicated worldwide (Dutta and Bose, 2006).In corporate governance circles, board gender diversity refers to the inclusion or presence of female directors in the boards (Ekadah and Mboya, 2012). Modern organizations are increasingly approaching board gender diversity as a value-driver in organizational strategy and corporate governance (Marinova, Plantenga, and Remery, 2010). The subject also remains an emergent area of concern for public debate, academic research, government considerations and corporate strategy across the societal landscape as well as in the boardroom and top executive positions.

Theoretical Review

The concept of board gender diversity can be explained by both agency theory and resource dependency theory. This paper will examine board gender diversity a corporate governance variable based on these two theories.

Agency Theory

Jensen and Meckling (1976) developed the agency theory advancing that the agency relationship is a contract under which one or more persons (the principal) engages another person (the agent) to perform some services on their behalf. The process involves delegating some decision making authority to the agent. The theory is premised on the inherent conflict of interest between the owners and management thus forming the basis for introduction of strong governance mechanisms(Donaldson and Davis, 1991; Heenetigala, 2011) .Separation of ownership and control therefore creates an inherent conflict of interest between the shareholders (Principal) and the management (Agent) (Aguilera, Filatotchev, Gospel, and Jackson, 2008). This thus implies that although managers are meant to be rational, they cannot be trusted to always act in the best interest of the principal because they are also presumed to be self-interested (Williamson, 1975) . This therefore points to the need for managers to be controlled to avoid moral hazards using some risk-bearing and monitoring mechanisms that checkmate deviant behaviors.

Agency theory advocated for a clear separation between decision management and control (Fama and Jensen, 1983; Jensen, 1986; Jensen and Meckling, 1976) Further, Eisenhardt (1989) elaborated that agency theory is concerned with resolving two problems that arises from conflict of the desires or goals of the principal and agent and/or when it is difficult or expensive for the principal to verify what the agent is actually doing. Eisenhardt (1985) posits that agency theory suggests two underlying strategies of control including behavior and outcome based. Both strategies rely upon performance evaluation. To mitigate these, scholars have suggested various governance mechanisms (Bathula, 2008). Agency theory thus provides a basis for firm governance through the use of internal and external mechanisms (Roberts, McNulty, and Stiles, 2005; Weir, Laing, and McKnight, 2002).These should be designed to ensure agent-principal interest alignment, protect shareholder interests and thus minimize agency costs(Davis, Schoorman, and Donaldson, 1997). Board balance comprising representation from diverse groups such as different gender provides a more balanced board that is likely to prevent an individual or a small group of individuals from dominating the decision-making process(Hampel, 1998).

Agency theory thus predicts the presence of women directors on board to improve corporate performance.

Resource Dependency Theory

Resource dependence theory provides a theoretical foundation for the role of board of directors as a resource to the firm(Hillman, Canella, and Paetzold 2000; Johnson, Daily, and Ellstrand, 1996). The resource dependency theory appreciates the strategic importance of other stakeholders beside the immediate shareholders in guaranteeing firms' access to resource through affiliation with various constituencies(Lawal, 2012).The role of board of directors under resource dependency model is that directors use their individual external network of contacts to attract indispensable resource that the firm needs to operate competitively and advance superior performance(Daily, Dalton, and Canella, 2003; Hillman et al., 2000) . Resource dependency theory focuses on the role that directors play in providing or securing essential resources to an organization through their linkages to the external environment(Hillman et al., 2000). Consistent with this view, Johnson (1996) observed that resource dependency theorists provide focus on the appointment of representatives of independent organizations as a means for gaining access in resources critical for firm success. The provision of resources enhances organizational functioning, firm's performance and its survival (Daily et al., 2003). The major argument of the resource dependence theory is that organizations attempt to exert control over their environment by co-opting the resources needed to survive (Pfeffer and Salancik, 1978).

In an earlier study, Pfeffer (1972) showed that the board size and background of outside directors are important to managing an organization's needs for capital and the regulatory environment. Hillman (2000) opines that directors bring resources to the firm, such as information, skills, access to key constituents such as suppliers, buyers, public policy makers, social groups as well as legitimacy. Williamson(1984) advanced that apart from gaining access to the required resource, firms with appropriate network connections are also able to reduce the transaction cost associated with interaction in the external environment. Other scholars also used resource dependence theory to explain the composition of boards, especially in terms of outsider representation(Bathula, 2008) Pearce and Zahra (1992) submit that outsiders are appointed on the board in order to bring a fresh perspective when the firm is not doing well. Resource dependency theorists argue that boards provide means for gaining access to resources critical for firm success(Johnson et al., 1996). It is can be argued therefore that female members on the board benefit the firm's governance through an influx of skills, abilities and fresh perspectives and by bringing new dynamics to board deliberations (Jamali, Safieddine, and Daouk, 2007). From resource dependency theory perspective, it can be predicted that a well diversified board improves firm performance.

Empirical Review

Board gender diversity refers to the presence of women on corporate boards of directors or women representation on boards (Dutta and Bose, 2006; Julizaerma and Sori, 2012). Although it is a growing area of corporate governance research in recent years, most empirical research on the subject is restricted to developed countries(Habbash, 2010; Kang, Cheng, and Gray, 2007). Empirical evidence depicts the presence of women directors in board level positions as responsible for various firm outcomes. The relationship between gender diversity and firm performance has however been inconclusive and still open to further empirical enquiry. Some studies established a positive and significant relationship between gender diversity and firm performance. In Malaysia, Julizaerma & Sori, (2012) carried a study and reported that a positive association exists between gender diversity and firm performance (Return on Assets). Similarly, in Singapore, Fan (2012) using 390 observations from different sectors listed on the Singapore Exchange between 2002 – 2004 in a research on gender diversity and performance, found evidence to support a positive relationship between board diversity and financial performance. The study employed simultaneous equations of multiple regressions in the analysis to control for the possible problem of endogeneity (Tobin's Q). Prihatiningtias (2012) using a cross-sectional time-series data in Indonesia, sought to establish the impact of the presence of women in the boardroom on firm financial, social and environmental performance. The results indicated that gender diversity had positive influence on firm financial performance. Moreover, the results from the qualitative approach demonstrate that the women board members, especially women directors, believe that they may bring positive effect in organizational improvement, which may then enhance firm performance as a whole.

Additionally, Dutta & Bose (2006) carried a study in Bangladesh and reported a paradoxical relationship between gender diversity in the boardroom and financial performance(Return on Assets and Return on Equity) of commercial banks in Bangladesh. The study used a small sample of 15 banks and non-parametric methodology (Kruskal-Wallis H test) and this may partially explain why the study yielded conflicting results at different significance levels thus no conclusion. In U.S , Dezso & Ross (2012) carried a study using 15 years of panel data on the top management teams of the S&P 1,500 firms. The study used longitudinal data to allow inclusion of firm fixed effects in all regressions. The researchers found that female representation in top management improved firm performance. In Denmark, Smith et al. (2006) carried a study to investigate whether women in top management affect firm performance. Using data from 2,500 largest Danish firms between 1993-2001 and various ordinary least square regressions models the research found that the proportion of women in top management jobs tends to have positive effects on firm performance, even after controlling for numerous characteristics of the firm and direction of causality. Another study in Spain by Campbell and Minguez-Vera (2007) found that the percentage of women in the board of directors has a significantly positive impact on performance (Tobin's Q value). Another study in US by Bart & McQueen (2013) reported that female directors achieved significantly higher scores than their male counterparts on the complex moral reasoning dimension which essentially involves making consistently fair decisions when competing interests are at stake. They concluded directors are compelled to make decisions in the best interest of their corporation while taking the viewpoints of multiple stakeholders into account, having a significant portion of female directors with highly developed complex moral reasoning skills on board would appear to be an important resource for making these types of decisions and making them more effectively.

On the other hand, there is evidence from previous studies to support a significant and negative relationship between gender diversity and firm performance. For example; In UK, Haslam et al (2010) investigated the relationship between the presence of women on company boards and both accountancy-based and stock-based measures of company performance. The study used multiple regression analysis and data between the years 2001 and 2005 for all financial time stock index 100 companies (100 companies listed on the London Stock Exchange with the highest market capitalization).

The researchers established a negative relationship between women's presence on boards and stock-based measures of performance (Tobin's Q). Bohren and Strom (2006) found that gender mix in the boardroom is negatively related to financial performance of non-financial firms listed on the Oslo Stock Exchange. Haslam et al (2010) additionally reported a negative relationship between women presence on boards and stock-based measures of performance. In US, Adams and Ferreira (2009) sampled observations from 1,939 firms for the period 1996–2003 . Using the ordinary least squares model, the study found that more gender diverse boards devote more effort to monitoring managers and there existed a negative relationship between the proportion of women on the board and performance. There are also studies that found no evidence linking board diversity to firm performance. For example, In U.S, Carter et al (2010) used a sample of 2,300 firm years in S&P 500 index for the five-year period of 1998–2002 to investigate the relationship between the number of women directors and the number of ethnic minority directors on the board, important board committees and financial performance. The study found that there was no significant relationship between the gender or ethnic diversity of the board, or important board committees and financial performance. Randoy (2006) studied 500 largest companies from Denmark, Norway, and Sweden and found no significant effect of gender, age, and nationality diversity on stock market performance or on return on assets. In the UK, Gregory-Smith (2013) found no evidence to support the argument that gender diverse boards enhance corporate performance.

Marinova et al (2010) based on evidence from the Netherlands and Denmark investigated the impact of board gender diversity on firm performance using a sample of 186 listed firms (102 from Dutch and 84 from Danish)and two-stage least-squares estimation. He found no effect of board gender diversity on firm performance. Dobbin and Jung (2011) applied cross-sectional time-series models between 1996 to 2007 to investigate whether the presence of female directors in the board affects company's profit and stock performance among the largest US firms. Their results indicate that companies with more women in the board of directors do not experience any increase or decrease in profits. In Kenya, Ekadah & Mboya (2012) examined the effect of board gender diversity on the performance of commercial banks in Kenya using a sample of 32 commercial banks between 1998 to 2009. Using stepwise regression, they established that board diversity had no direct effect on performance of banks in Kenya. Likewise, in UK, Haslam et al (2010) found no direct relationship between women's presence on boards and financial measures of performance. The study measured performance using financial indicator (return on assets, return on equity).

Critical Review of Existing Literature

Existing literature indicates that there is a relationship between corporate governance, in particular board gender diversity and corporate performance (Fan, 2012; Haslam et al., 2010; Julizaerma and Sori, 2012).However, several research issues are yet to be addressed sufficiently. It is well documented and argued in the literature that diversity among board members has the potential to influence firm financial performance yet few studies have been undertaken to examine whether this also applies to non-financial performance measures (e.g. innovation, employees retention and customer satisfaction). Additionally, studies on board gender diversity have largely placed and drawn from the developed countries which are different in its economic and socio-cultural structure from the developing world. Literature on gender diversity in developing countries is thus limited and scarce. The research findings in developed countries may not be applicable and generalized across national boundaries due to regulatory environment and cultural differences.

Further, the few studies done in developing country suffer from methodological limitations such as use of case studies and secondary data. More research should therefore be carried out using survey and primary data to reinforce the findings and provide a deeper understanding on the relationship between gender diversity and firm performance. Additionally, most previous studies are limited to only to firms listed in the securities exchange, thereby excluding insights from other segments of the economy which form the bulk of the existing formal business organizations. This raises the issue of sample bias. Lastly, although there is considerable amount of literature highlighting the influence of board gender diversity on firm performance; existing literature does not demonstrate a definitive relationship between board gender diversity variables and firm performance.

Empirical evidence on the association between board gender diversity and firm performance is equivocal and inconclusive with prior studies yielding conflicting findings. Empirical evidence on the association between the gender diversity and firm performance reported mixed and conflicting findings. Prior studies find no association(Ekadah and Mboya, 2012; Haslam et al., 2010); other studies find either a positive (Fan, 2012; Julizaerma and Sori, 2012) or a negative relationship (Adams, Almeida, and Ferreira, 2009; Bohren and Strom, 2006; Haslam et al., 2010) between gender diversity and firm performance. Therefore, the relationship between gender diversity and firm performance is inconclusive and is thus still open to further empirical enquiry.

Conclusion and Recommendation for Future Research

The present paper reviews the literature on board composition from a board gender diversity perspective and examines its influence on corporate performance. The article also highlights some avenues for future research which are discussed below. First, even though a reasonable consensus exists in the literature suggesting that corporate governance, in particular, board gender diversity, influences firm financial performance, very limited research actually examined whether diversity among board members has any influence on non financial performance measures. Majority of empirical papers exclusively focuses on the effects of board diversity on corporate financial performance. Future studies therefore need to examine the link between gender diversity and non financial performance.

Additionally, most of the previous studies suffer from methodological drawbacks such as use of cross sectional surveys which limited identifying causality between board diversity and corporate performance. Future studies may therefore undertake longitudinal studies to address this issue more conclusively. Further, the few studies done in the developing world on the link between gender diversity and firm performance did not engage a sampling technique but largely used case studies hence a limitation in their ability to speak and be generalized to larger populations. Although there is a great deal of literature which linked gender diversity to corporate performance in developed countries, there is limited research on this relationship in developing countries. Future studies may thus explore research on this relationship in developing countries and in particular in the African context.

Most existing studies only consider agency theory and resource dependency theory when studying the link between gender diversity and performance. The researchers thus recommend that future authors study the relationship between gender diversity and corporate performance through the lens of other theories such as, stewardship theory, institutional theory, stakeholder theory, transaction cost theory and political theory to better understand the relationship between gender diversity and firm performance from different theoretical perspective. Finally, based on the previous studies, there is a paucity of existing literature that examined the association between gender diversity and corporate performance particularly with any moderating or mediating effect of other variables. Future studies may therefore introduce moderating and mediating variables on the relationship between gender diversity and corporate performance. The researchers further recommend that future studies in the area need to be domiciled in a developing world context with an aim of addressing identified knowledge gaps on the relationship between gender diversity and corporate performance. The results obtained from this research will be presented in a later article.

Implications of the Research

This research will be useful to policy makers in both public and private sector. By illustrating the relationship between the corporate governance aspect of board gender diversity, and its influence on corporate performance, policy makers will use the finding of this study to better align or revise the existing legal framework, policies and the guidelines of corporate governance. The corporate governance authorities, especially in the Kenya, will use this research as empirical support for developing their regulations and making further recommendations on corporate governance aspect of board gender diversity. Stock market authorities can also employ this study's results to evaluate the current board composition practices and the role of board gender diversity in influencing corporate performance. New corporate governance regulations and revisions of existing corporate governance codes should be based on evidence from empirical studies such as evidence offered by this research. Further, the findings will influence the government to develop appropriate policy to enhance growth of private and public sectors to accelerate corporate performance and support the achievement of country's vision 2030.

This study has practical implications for corporation's need to diversify the board of directors in order to improve company's performance. Recently, a growing amount of contemporary research on boards suggests that diversity among board members has the potential to increase board effectiveness and therefore enhance performance. Additionally, the findings of this study will also benefit the government, the Kenya Association of Manufacturers, the Capital Markets Authority, the Kenya Private Sector Alliance, institutional and individual investors by providing them with in-depth understanding of the relationship between gender diversity and corporate performance. Similarly, the finding of this study will be of significance to other African developing countries and especially the members of the East African community, that are culturally, economically, and politically similar to Kenya's.

Finally, this study contributes to the corporate governance research by providing comprehensive model of board gender diversity characteristics. The study will thus benefit the scholars wishing to undertake further studies aimed at improving corporate governance structures in local and global context. Lastly, the framework developed in the study will be a useful tool to academics and other researchers wishing replicate this study in different sectors and populations.

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