Linking firm performance with board diversity: A literature review

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ABSTRACT

When we hear the word diversity, usually the first word that comes to mind is difference, and diversity steams from difference, in this paper, board diversity is discussed, in addition to linking it to firm performance, diversity is important, and it's especially important in the board room of a given firm because it allows for different perspectives and opinions which can impact the decision-making process in the firm, which ultimately can affect the performance of the firm. The purpose of this paper is to give a relational guide on how board diversity can greatly impact the achievements of a firm. This paper is a theory-based study and aims to develop a critical approach of defining board diversity and linking that to the performance of the firm. This paper is a theory-based study because it utilizes the existing literature in order to determine the impact of board diversity on firm performance. This study also uses different theories and existing literature to highlight the relevance of having a diverse board in the firm. To find the relation, various studies and existing literature were analyzed to develop a critical approach to relate board diversity to firm performance. In conclusion, this paper outlines different aspects of board diversity while providing a critical look that allows us to assess the importance of board diversity and its connection to firm performance.

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Introduction

While many decry the importance of people from different regions to be in one single room discussing and exchanging ideas, the others appreciate and in what would be a step ahead, retain it. Heterogeneity, demographical and cognitive aspects can act of a great recipe for whichever organization that wants to become successful. The topic of this paper is however not new though it has been a theme for centuries to the core of organizational culture. As faster as cancer on human flesh; so as diversity impending on discussions about firms. Not only has it led to criticism, well, according to recurring scenarios and examples supported by existing literature and legal authorities, it can be seen that the need for diversity in boards has become more reliable and relevant. Today women's' number is dramatically still low and therefore there is need for firms to increase on women participation (Owen, 2018), In a study by (Dankwano, 2018), it was found that the reason for negative returns on assets by some firms was due to having a lesser number of return on assets was because women were minorities, he therefore suggested for firms to at least have three female representatives on board for firms to be effective. In the resource theory, it assumes that with the increase in the number of workers, productivity and performance also increases in a positive way. However not all size matters, researchers become divided when it comes to board diversity (Aggarwal, Jindal, & Seth, 2019).

Into the bargain, (Mbaba, 2016) proposed for smaller boards to be adopted by firms because they are effective in monitoring management, influence decisions in a timely manner thus resulting into higher firm performance. Real directors work hard to achieve the major aim or goal of becoming the number personality who raised a rock to the peak of a mountain. It is not born or taught; anybody can be a manager as long as he remains in line within the interests of the business. This calls for efforts that should be centric

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to success and being optimistic can be the rubber to prevent this manager from falling onto a live electric wire (developing incompetence). Thus, organizations are encouraged to adopt a strategy that will evaluate directors' competence, which is also a good choice to include diversity on a board structure (Rampling, 2011).

As mentioned earlier, the goal of this paper is to develop a critical approach to look at and assess board diversity and its connection with firm performance, this approach can be developed through the following

The main objective of this paper is to assess the existing literature linking between board diversity and firm performance, discussing future possibilities and direction of diversity and firm performance. This paper begins with a literature review and continues with fundamental dimensions of board diversity studies in management linking with business performance. This study concludes with fundamental highlights and future directions.

Literature review

Theoretical and Conceptual Review

Board diversity-based studies are connected with several theories in the literature. This paper relies on stakeholder theory of Robert Freeman to assess the relationship of stakeholder with firm performance.

The idea that corporations have stake holders has now become a common place in management literature, both academic and professional (Thomas, D., & Lee, E. P, 1995). One of the classical definitions of stake holder "any group or individual who can affect or is affected by the achievement of a corporations' purpose (Freeman R. E., 2004), and at its broadest and most ambitious, stakeholders concept holds a redefinition of all the organizations: how they should be conceptualized and what they should be (Andrew, 2006). As businesses have internal and external environment that helps it in its operations, its urged on the other hand that the environment also act as its stakeholders. Never the less, when an organization misrecognises its external society, there may be a bigger impact. The denial to admit that the external groups do have a stake in the firm (Freeman E. R., 2010), may have an implicit impact on a firms performance. A stake holder approach emphasizes the importance of investing in the relationship with those who have stake in the firm. A stake holder is deemed to contribute to the performance if he is in good terms with the rest of the board. Remember that a stakeholder obligations and therefore stakeholder status, are created when the organization voluntarily accepts the contribution of some group or individual (Robert P. , 2015). Their preferences come from perceptions regarding how transactions, relationships and interactions of the firm influence the utility they receive (Jeffrey, 2013). Stake holders can be of beneficial to a firm though on the other side they may be also be destructive towards achievements of a firm. Furthermore, the separation of risk bearing and decision- making may be the problem that can arise between major stakeholders (Robert P. R., 2003), a block to firms' performance. Sustainability is now the agenda of businesses as they ask themselves what measures should be implemented to remain flexible to customers and insiders of the organization. Thus the relationship between organizations and stakeholders are crucial to achieve the difficult balance between the economic, social, and environmental dimensions that implies the implementation of sustainability (Diego, 2018). In addition, (Stephen, 2017) suggested that managers at BMW discovered how running an organization in a more sustainable way means making informed decisions based on clearly and openly communicating with stakeholders and also understanding their requirements, this might also act as a tool to reduce unrests that would arise from conflicts of interests.

Agency theory has been one of the most important theoretical paradigms (Boučková, 2015); in management and performance evaluations. It was defined by (Jensen & William, 1976) as a contract under which one or more persons (the principal(s)) engage another person named the agent to perform some services on their behalf which involves delegating some decision making authority to the agent. Agency theory can therefore be called a relationship between two groups, a principal and agent(s). The theory also enables the principal to oversee what his ordinate counterpart the agent does during business operations. However, principal-agent relationships can also be destructive to the development of the firm, especially where the appointed agent and principal have conflicting interest into the firms. In fact, the relationship may also be stroked by information asymmetries and misaligned incentives from either parties (Sunit, 2014). In addition, a principal agent relationship cannot be diluted in businesses. It would thus be difficult to operate in a modern economy than a few hours without interacting with an agent (Dalley, 2011). Apparently some people act as agents to firms without expertise and experience in languages used in host countries that they carry operations. Moreover, since stakeholders and managers have a relationship, we can say that they portray some sort of principal-agency relationship. This relationship in most cases is supported by uncontrollable costs such as; statutory and common law and human ingenuity, both laws being important to the existence of the business. In conclusion, it important for a principal to appoint and agent with whom he feels at peace with; however, this may be risky as the agent might be underutilized by simply following traces of his master (principal) to avoid conflicts.

There are vast studies conducted to board diversity in conjunction with firm performance. Some were positive while others addressing a negative relationship of board diversity with firm performances. In the article of (João, B. F., & Vinícius, A. B. S., 2012) titled "Board diversity and firm performance: An empirical investigation in the Brazilian market", it was concluded that "Brazilian companies without majority control indicated a relationship between diversity of educational aspects of the board members and firms market performance, presence of women on boards was small but firms that had at least one woman significantly presented a positive market performance better than those without women". However, in the article by (Marc, 2014) titled "the impact of management board diversity on corporate performance-An empirical analysis for the German two-tier system", it was concluded that it there was

negative effects of board diversity characteristics on corporate performance regarding demographic characteristics of people, economic effect of board diversity results from an exchange of experiences and expertise between board members. The studies about diversity clearly set up the climax of the importance of women in firms. In the article of (David, 2003) “Corporate governance, Board diversity, and firm value”, significantly a positive relationship between the presence of women or minorities on the board and firm value as measured by Tobin’s Q, firms making commitments of increasing women on board also have minorities and vice versa. Furthermore, in the article “Board of director diversity and firm financial performance” by (Niclas, James, & Charles, 2003), results indicated that diverse boards were in conjunction with firm financial performance, citing that firms should seriously consider the potential for the enhanced representation and perspective diversity might create. Lastly (Merve, K., & Cemil, K., 2016) in their study that used data from BIST (Borsa Istanbul stock market) from 2008 to 2012 found out that gender board diversity had a significant relationship with financial firm performance as measured by return on assets and return on equity, females have a potential to increase performance by proposing different approaches and views to board discussions.

Empirical Review

Board diversity and its importance in management studies

Board diversity as explained by Gonzalez & Denisi refers to the differences between individuals on any personal attributes that determine how people perceive one another (JORGE A. G., 2009). While diversity research has progressed over the last 40 years (Lynn M. S.-H., 2009), scholars have suggested that intervening variables between board diversity and firm performance must be examined to uncover when and how diversity improves performance (Toyah & María, 2009; Yilmaz et al., 2021). The effects of the concept diversity are studied in a variety of fields ranging from macroeconomics to social psychology (Mariassunta, 2019). Moreover, in most studies, evidence that board diversity benefits firms, however has been mixed (Stephanie, 2019), most of them on the other side however focus only on gender as a basis of studying and measuring the benefits of board diversity. In the journal of Toyah miller et al, it was found that there was a positive relationship between board gender diversity and innovation (Toyah, M., Maria, D. C. T, 2009).

A company or organization without board diversity may face consequences that may result from un-innovative board members. The concept of transformational leadership was first introduced by James MacGregor Burns in 1978 (Bruce & Mokua, 2019), it must be acknowledged that transformative leaders spur to greater innovation and effective impact on decision making. (Price, 2019). The inherent assumption seems to be to be that when decisions are made about individuals such as hiring decisions (Lynn M. S.-H., 2009), diversity then plays it remarkably. Diversity in organizations is a factor contributing to success and prosperity. Some of the strategic roles of the board is to advice top management, ratify and review strategic decisions (Daniel, 2015). In the study of (Niclas L. E., 2003), it was mentioned that diversity follows dimensions of demographic that are observable such as gender, race and cognitive which is non-observable such as knowledge, education, values, in the end the study suggested that women and minorities who serve on boards of directors may be more effective decision makers.

Key elements for business performance

Firm performance and organization competitiveness are different. Although there are a lot of studies and papers made on board performance and firm performance, most of the researchers’ conclusions are subjective. Perhaps whether or not managers can or do seek to maximize the value of their firm in their decision making is less important (Alison, 2007), the concept of firm performance needs to be distinguished from the broader construct of organizational effectiveness (Hacioglu and Aksoy, 2021; Juliana, 2012). What constitutes a good measure of academic performance, parts of them are made according to editors publishing competence (Isabel, 2016). Can a continuing firm be called successful or performing? If so, what may be the likely indicators of performance. Jan and Goldberg suggested that accounting tools such as profitability, Lerner index, sales per input and total factor productivity can be used to assess firm performance (Jan, 2013).

Figure 1: A demographically structure and its relation to performance organization; *Source:* Author

Performance is all about benefits that employee or working groups provide to the business (Hacioglu & Sevgilioglu 2019), in fact it is bigger than what managers of companies think. In addition, the concept of performance in firms evolves around five elements which are financial performance, customer and employee satisfaction, social and environmental performance. These elements are also a reason as to why companies structure their boards in line with their business environment (Satwinder, 2018). Performance improvement will occur if diversity and inclusion are both simultaneously engaged (Economics, 2016). Therefore, whereas managerial boards only attach firm performance to their financial contentedness, other factors surrounding the firm should ought to be considered. Then why should we measure performance? Empirical studies use return on investments and Tobin's q to assess whether firms perform.

Linking firm performance with board diversity

As seen in the literature review summary table (Table 1), most studies imply that board diversity has an impact on firm performance. Thus firms that have diversity in their structure are more likely to achieve transparency and innovation in their operations. It should also be noted that most empirical evidence on performance effort of board diversity is mixed (Austin, 2012), allowing new research projects to be done to assess the relevance of diversity in organizations. Particularly, (Muhammad, 2019) identified two key roles played by corporate boards, one being a monitoring role and the second being advisory/role. Boards play a big strategic role in defining strategic directions for organizations to become successful. In addition, Nicolas suggested ways how boards fulfil their role of monitoring by representing shareholders, keeping track of organizations' finances and responding to takeovers and hiring. Moreover, boards also have tasks of controlling decisions, (Eugene, 1983) outlined that decision management and decision control are the components of the organizations' decision process or decision system.

Furthermore, research also recognizes and credits women's' participation; to firm performance (Tariah, 2019). Before looking at how women are more beneficial to firms, let's look at why they are necessary to be premiered on boards of firms. Indeed, it is surprising and more attractive that it is one of the principles ushered by United nations; government and investors acting to have diverse boards (Dicker, 2019); to increase gender equality in organizations. In Europe, publicly traded companies are required to have at least 40% of boards to be comprised by women. (Creary, 2019). Barack Obama in one of his statements at a speech while at Singapore Expo said that "if every nation on the world was run by a woman, a significant improvement would be achieved (Chandelis, 2019)" It is even interesting that scholars too get interested in women when they write about board diversity. (Lone, 2016) carried out a study on 2 million companies across 34 European countries, a high positive association between women's share on firms and return on assets was high, however doesn't always guarantee improvement in firm's performance (Creary, 2019). Notwithstanding, some researchers have refuted claims of women having an effect on firm performance, for example, (Francesca, 2016) found out that the more the number women increases, return on assets too decreases diminishingly, board-size relationship is that many boards; are inefficient (Eisenstein, 2019) and persistently too big thus women being many on the board having no greater importance (Paul, 2009).

Table 1: Literature Review on Firm Performance and Board Diversity

Category	Authors	Subject	Components	Approach/method/model	Findings
Stakeholder approach and agency theory	Thomas, D., & Lee, E. P. (1995)	The stakeholder theory of the corporation: Concepts, evidence and implications.	Stakeholder management, performance, diversity	Descriptive, Empirical and normative study	The ultimate justification for stakeholder theory is to be found in normative base. Stake holder theory is managerial and constitutes attitudes, structures.
	Freeman, R. E. (2004)	The stake holder approach revisited.	Strategic management, stakeholder management, business ethics, corporate social responsibility	Theoretical review	Managers should make corporate decisions considering stake holders. Prioritizing stake holders is the most genuine component.
	Robert, P., et al. (2003)	What stake holder theory is not.	Power, Stakeholder, corporations	Theoretical, conceptual	Separation of risk bearing and decision-making may be the problem that can arise between major stakeholders.
	Diego, F. U. et al. (2018)	What is going on with the stakeholder theory in management project literature? A symbiotic relationship for sustainability.	Project management, project stakeholder management, stake holder theory	Descriptive analysis	Sustainability is an imperative for the survival of organizations. -Through social and environment dimensions a relationship creates sustainability of an organization.

Empirical studies background	Table Cont'd	Fundamentals of management.	Sustainability, management environment	Observation, review	Analysis	Stakeholder engagement is crucial in the management of organization.
	Stephen, P. R. et al (2017)					
	Jeffrey, S. H., & Andrew, C. W. (2013)	Stake holder theory, value and performance	Value, performance measurement, stakeholder theory, happiness	Four-factor model, theoretical review		-Firms that treat stake holders well have higher probability of retaining them.
	Marc, E., et al (2014)	The impact of management board diversity on corporate governance: An empirical analysis for the German two-tier system.	Board composition, diversity, corporate governance.	Data analysis, correlation, multiple regression		Great internationality can decrease communication between board members thus stake holders ought to be locally.
	Freeman, R. E. (2010)	Strategic management: A stakeholder approach	Strategic management, stake holders, managers	Stake holder model and approach.		Stake holder notion can be used to strengthen current art of strategic management
	Andrew, L. F., & Samantha. M. (2006)	Stake holders theory and practice	Corporate social responsibility, corporate strategy, stake holder theory	Stakeholder approach		Stakeholders manipulate the direction of a firm.
	Dalley, P. J. (2011)	The theory of agency law	Agent, responsibility, Causation, English law	The cost benefit internalization theory, Agency theory		Agency law can be applied to solve problems that linger in indifferences caused by stakeholders.
	Boučková, M. (2015)	Management accounting and agency theory	Information asymmetry, agency theory, management accounting	Rochester model, agency theory, transaction cost economics theory		Globalization and liberalization of markets leads to increased competition and firms require timely management.
	Jensen & William (1976)	Theory of the firm: Managerial behaviour, agency cost and ownership structure	Internal control systems, conflicts of interests, capital structure, internal equity, Agency costs and theory	Agency theory, theory of the firm,		Statutory and common law are relevant for individuals to minimize agency costs.
	Sunit, N. S. (2014)	The principal-agent problems in finance	Principal-agent, collateralized debt obligations, contract structures	Agency theory, multivariate extreme value theory		A more sustainable financial system requires a more trustworthy reputation for the industry. Low pay schemes to agencies incentivize them to sacrifice accuracy for speed.
	Merve, k., & Cemil, C. (2016)	The effect of board gender diversity on firm performance: evidence from Turkey	Board of directors, financial performance, gender diversity, Board diversity	Regression analysis		Female inclusion in board has a higher relationship with financial performance.
	Niclas, L. E. et al (2003)	Board of director diversity and firm financial performance	Firm organization, heterogeneity, diversity	Correlation, regression analysis		Diverse boards are in conjunction with increased performance.
	David, A. C. et al (2003)	Corporate governance, board diversity, Firm value	Financial value, diversity, corporate governance	Regression.		There is a relationship between firm value and diversity of directors. -women, size

Table Cont'd	The impact of management board diversity on corporate performance- An empirical analysis for the German two-tier system	Board composition, diversity, corporate governance.	Data analysis, correlation, multiple regression	A positive relationship between board diversity and corporate performance was negative.
Mac, E., & Carolin, V. U (2014)				
João, B. F., & Vinícius, A. B. C.(2012)	Board diversity and firm performance: an empirical investigation in the Brazilian market	Control of shares, board of directors, diversity	Estimation, regression analysis	There was a relation between educational aspects of board members and firm performance.

Conclusion

This paper developed a critical outlook on board diversity and its connection to firm performance, using previous studies and literature, the approach can be defined in the following :diversity is important for most firms, the degree of importance is determined by many different factors like the cultural nature of the firm, the direction of the firm, furthermore, decision making is impacted by the diversity of the board, as it turns out having more diversity results in more insights, insights then will impact the decisions taken by the board ultimately affecting the firm performance positively or negatively. From evidence availed by this paper, it is important for firms to address the issue of board diversity to be effective in performance. It was clear that a diverse board will enhance the decision-making process of the board which has a direct impact on the performance of the firm. With aid from available literature, it is necessary for corporations to consider a diverse board while keeping in mind elements such as Gender, Age, Geographical and cognitive values such as skills, educational level, religion. This paper also highlighted authors supporting board diversity motion to firm performance, reflecting consequences of not having a diverse board as well. The study aimed at analysing how performance is measured by managers and directors. Furthermore, it is concluded that firms having diverse boards are likely to perform better than those without diverse boards. The two elements that raise the flag of having a diverse board is innovation and high decision making. This paper has a positive view of board diversity but it does not mean that every organization should have a diverse board. In addition, Future direction of board diversity suggests that boards will have higher numbers of female members.

This paper may be used for future studies on board diversity and its connection to firm performance.

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