

Reviews on the relationship between gender diversity and corporate governance

Xuejian Lai

Guangzhou Huashang College, Guangzhou, Guangdong, 511363, China

Abstract: *This review examines how gender diversity on corporate boards influences corporate governance outcomes that in turn impact performance. We begin with a brief discussion of the women on board and then describe extant research on the relationship of gender diversity among these areas: (1) Firm Performance; (2) Financial reporting quality; (3) Audit quality; (4) Firm risk.*

Keywords: *Women on board; Gender diversity; Firm risk*

1. Introduction

Advancing equal participation of women on corporate boards has increasingly become the focus of societal and political debates in many countries because having gender diversity on boards is beneficial to the firm. It is believed that diversity influences better financial performance since diversity offers more independence, innovation and better corporate governance. Moreover, having women on boards provides boards with various thoughts, higher competitive advantage and diversity of skills. It is universally acknowledged that diversity of thought results in better decision-making, therefore leads to a better firm performance and then lowers firm risk (Loukil & Yousfi, 2016) ^[3].

In contrast to most of studies revealing positive influence of gender diversity on boards, there are some scientific studies have investigated the relationship between women on boards and firm risk is negative or neutral. This empirical discrepancy leads to conflicting evidence about the relationship between increased female directors on boards and firm risk, resulting uncertainty for policy makers, chief executive officers and investors all over the world. Thus, investigating the relationship between gender diversity and firm risk is still an important issue in financial academic world.

2. Literature review

2.1 Gender diversity and Firm Performance

A board of directors plays important monitoring and advising roles in a company because it monitors the activities of a firm, makes decisions on issues, and supervises managers and also serves as corporate governance mechanism. In the monitoring function, the board of directors plays a “watchdog” role to align the actions of the top management with the interests of the shareholders (Chen, 2008, p. 1). It means that, the board, should monitor whether executive performance in accordance with the board’s expectations as shown in policies (Scholl, 1995). While the advisory role requires the advisory directors to provide professional advice that help managers to establish corporate strategies and policies or identify and evaluate potential opportunities when undertaking some risky but value-enhancing investments (Li, 2016). Thus, the effective monitoring and advising roles of the board can help the firm to determine the right corporate strategies therefore contribute to the improvement of the firm performance.

A board has a lot of components, like board size, independence of the board, the expertise of the directors and so on and so forth. There are many studies show that smaller board size can improve the firm performance because small size boards are more effective in monitoring CEO compensation and can increase pay-performance relationship compared to large size boards (Ozkan, 2007; Fahlenbrach, 2009). Besides, a higher proportion of outside directors can improve firm performance since equipped with the directorship of them on other various boards, outside directors have accumulated experience, expertise in advising and monitoring the top management team (Fama and Jensen, 1983). The independence of the board can also improve the firm performance because it can be in a better position

for fair appraisal of the top management, that is, CEO performance appraisal in accordance with their performance, which enhance board's effectiveness and then improve firm performance. Apart from above components, board diversity is a vital part of a board structure for it has an important influence on business behavior and outcomes. One of the main issue of concern is the effect of gender diversity on firm performance, so investigating the relationship between women on boards and corporate performance is necessary since it is related to profitability and investment strategies and other aspects of firm performance. As a matter of fact, many scholars found that women on board contribute better than men on boards. For one thing, Ryan and Haslam (2005; 2007) report that female directors tend to serve in precarious positions, which breaks the stereotype of women on boards and shows female directors can produce satisfactory results in that position. For another thing, Farrel and Hersch (2005) find that female directors are more likely to serve on boards of better performing firms and suggest that a shortage of supply allows women to self-select the firms, or that these firms are able to focus more on diversity goals.

In addition, Post and Byron (2015) reviewed research results of gender diversity and firm performance from 140 studies in 35 countries during the period 1997-2014 to examine if these outcomes different from legal and social contexts of companies. The reason why they selected this topic is that although there has been a great deal of debate about the impact of the representation of females in companies, it is still unclear whether the increasing presence of women on boards improves firm performance. Although a comparatively large body of literature examining the relationship between female board representation and firm performance, the empirical evidence is decidedly mixed. Based on their research evidence, they found that female board participation has positive effect on accounting returns in particular in countries that vigorously defend stakeholders and thereby, those countries have better market performance. Also, it noted that gender diversity improves monitoring and strategy involvement.

Works by Strøm et al. (2014) also found that the representation of women on boards is positive related to the business performance by providing regression result that female CEO relates significantly to ROA when board sizes are the same, after studying 329 microfinance institutions from 73 various countries for the years 1998-2008. Whereas, they note that lower meeting times on boards that have female directors makes weaker corporate governance. Similarly, De Luis Carnicer et al. (2007), in Spain, researched 2,000 largest companies, state that there is a positive relationship between the percentage of the women on boards and ratios of value added to income and cash-flow. Adler (2001) and Carter et al. (2003) demonstrated that the presence of women in senior management positions is positive related to the value of the company. That is because companies incorporate female directors add new values and viewpoints to the board, leading to greater business success, in other words, improving firm performance.

Pletzer et al. (2015)^[2] collected conducted a study of a sample of 20 studies from 3097 companies over the period 1997 to 2012 to investigate the relationship women on boards and business performance. They stated that there is no significant link between the higher presence of women on boards and firm financial performance, providing the evidence that shows neutral relationship between female directors of these companies and ROA, ROE and Tobin's Q.

The literature reviewed suggests having women at corporate boards has a complicated impact on corporate performance because the research work carried out till date have found positive, negative and neutral relationship between corporate performance and women on corporate boards. Thereby, gender diversity's influence on corporate performance is not yet clear which requires further investigations.

2.2 Gender diversity and Financial reporting quality

In spite of financial performance, the association between gender diversity on boards and earning management also is an important issue that people concern about.

Peni & Vahamaa (2010) tested for a relationship between earnings management and the percentage of women on boards suggested that female CFOs tend to adopt conservative earnings management strategies compared to male CFOs. However, in contrast to this finding, some authors draw opposite conclusions such as Gavius et al. (2012) ^[1] noted that greater female participation on boards is negative related to earnings management, supported by some gender theories and findings regarding a higher level of morality in judgements and behaviors as well as a higher level of anxiety among women than men. Female directors are more likely to blame themselves for failure, whereas men tend to display self-confidence, be certain of their success and explain failure through lack of desire and motivation.

Another crucial issue is that the relationship between women on boards and financial reporting since reports discussing whether there exists a gender influence remains limited. Authors like Firoozi et al. (2016) stated that gender diversity is not associated with improvement in financial reporting quality. Yet Francis et al. (2014) studied S&P 1,500 firms from 1988 to 2007 and demonstrated that hiring a female CFO is dramatically increase the degree of financial reporting conservatism. Also, Abbott et al. (2012) figure out whether board diversity affects the incidence of financial restatement, and the result is that there is lower likelihood of restatement of company that has women on boards, as more than 70% of restatement had boards that did not have even a single female director.

2.3 Gender diversity and Audit quality

At the auditing level, in the wake of the corporate failure such as Enron and Lehman Brothers, shareholders, governments and other concerned parties benefiting from those companies started worrying about the audit quality of a firm and wanted to probe the solutions that can improve the audit quality. One of the possible ways is to compose with gender diversity on board.

A number of research studies and surveys in the past have found that the higher proportion of women directors on boards is positively associated with audit quality. Ittonen, et al. (2010) examined S&P 500 firms in the U.S. during the period 2006-2008 and found that having more women on audit committees chairs can lower audit fees considerably by improving the effectiveness of the audit committees and monitoring activities of the financial reporting process from both demand-side perspective and supply-side perspective. Similarly, Thiruvadi (2012) stated that audit committees with at least one female director tended to meet their colleagues more often than those male-dominated committees. Therefore, the appointment of female audit committee members delivers a relatively positive message to the investors in the capital market because women are more likely to have conservative and ethical quality which can enhance the integrity of the financial reporting process.

Although above mentioned researchers concede that more participation of women on corporate boards has a positive effect on audit quality of a firm because of their conservative strategies and high ethical qualities, there is a totally different view of the relationship between gender diversity and the audit quality. Srinidhi et al. (2008) raised a research question that whether the female audit committee representation affects audit fees and studied 2,325 firms in the United States over the period from 2001 to 2003. The authors demonstrated that companies had at least one women director are more likely to pay more audit fees compared to those companies all male corporate board membership. Therefore, it is suggested that firms with female directors need higher audit effort due to complexity and ethical dilemma.

2.4 Gender diversity and Firm risk

After giving comprehensive review of research on gender diversity on boards, we cannot ignore how women presentation affects firm risk since corporate risk management is a critical concern of managers when they make investment decisions and these decisions boards made are closely linked to firm risk. The research shows increased diversity can lead to pros and cons in terms of desired outcomes, a board that has diverse directors influences firm risk either positively or negatively. Agency theory, resource independency theory indicate that independent directors may positively related to firm performance because independent directors tend to protest shareholders' interests rather than owner's interests. Nevertheless, executive directors have incentive to take risky activities in order to meet the profit targets, which may lead to a higher firm risk.

In contrast, there are massive results show that having women on boards lowers the firm's risk, for example, a higher number of female directors increases cash holding and investment opportunities, lower the variability of stock market return and the level of leverage because of their conservative strategies when facing financial issues (Lenard et al., 2014). Women on boards often bring a fresh perspective on complex issues and it helps correct informational biases in strategy formulation and problem-solving (Carter, D'Souza, Simkins, & Simpson, 2010). Women directors appear to ask questions, debate issues and take active role on boards, show their participative leadership and collaboration skills and hold their organizations to higher ethical standards. Furthermore, resource dependency theory suggests that women directors bring more unique and valuable resources and relationships to their boards. Arfken et al (2004) found that women may understand certain markets and consumers better compared to men. Also, gender role theory indicates that women are more flexible to manage ambiguous situations and women on boards enhances the creativity and innovation of the

boards (Srinidhi, Gul, & Tsui, 2011)^[3]. All these characteristics of women lead to a better decision maker and thus lower the firm risk. However, other researchers found that there are neither positive nor negative impacts of board gender diversity on equity risk (Sila et al., 2016) and no evidence that female boardroom influences the penchant for strategic and financial risk-taking (Loukil & Yousfi, 2016) .

Overall, many researchers explore the impact of the participation of female on boards on firm risk, although reporting mixed results, more positive relationship are found in recent studies.

3. Conclusion

The aim of this paper was to review the most significant studies of women on boards. We have identified what is known about how gender diversity influences firm performance. The evidence shows that gender diversity on boards contributes to more effective corporate governance like through a variety of board processes. As well as governance outcomes, women directors contribute to important firm level outcomes as they play direct roles as leaders, mentors and network members. Thus, research into women on boards is an important area needs to be investigated deeper in the future.

References

- [1] Gavious, I., Segev, E., & Yosef, R. (2012). *Female directors and earnings management in high-technology firms*. *Pacific Accounting Review*, 24(1), 4-32.
- [2] Pletzer, J. L., Nikolova, R., Kedzior, K. K., & Voelpel, S. C. (2015). *Does gender matter? Female representation on corporate boards and firm financial performance-A meta-analysis*. *PloS one*, 10(6), e0130005.
- [3] Srinidhi, B., Gul, F. A., & Tsui, J. (2011). *Female directors and earnings quality*. *Contemporary Accounting Research*, 28(5), 1610-1644.