

CONCEPTUAL FRAMEWORK OF BOARD DIVERSITY AND ITS RELATIONSHIP WITH CORPORATE GOVERNANCE

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Abstract: Board of Directors are the pillar for systems that guarantees that the interests of stakeholders and firm are aligned together by monitoring the working of firm as well. Gender, age, Nationality or independence of board etc are now a day's trending topic which should be studied deeply and mostly empirical research has been done on board diversity attributes and its relation with corporate governance. In this paper empirical study have been done by taking reviews of various authors on board diversity attributes and how corporate performance have been effected positively by solely following rules and regulations of corporate governance. The study have be extended across nation which can help to understand the different economic working, capital market, cultural differences, effectiveness of corporate governance body. This research provides conceptual framework of board diversity and its impact of governance body.

Keywords: Diversity, Board Independence, Corporate Governance, Financial performance.

Introduction of Corporate Governance:

Corporate governance is a code of conduct through which all the organizations are administered, directed and controlled. It is inculcated by mandated rules and regulation which are to be followed by all the members of organizations those are directly or indirectly related like, stakeholders, board of directors to create a strong relationship among all participants of the company (Charlie Weir, 2002). Corporate governance has three pillars- Directors and Shareholders and Top Management (Balasubramanian, 2014). The concept of corporate governance was introduced first time by Organization for Economic Co-operation and Development (OECD) by defining it as "Procedures and processes according to which an organization is directed and controlled". Transparency, Accountability, Responsibility, Independence, Social responsibility and Fairness are the main pillars of corporate governance. Effective governance reduces the risk and improves the quality of board decision-making thereby enhancing the performance of the firms for long period and also providing benefits to the stakeholders (Peter Wong, 2011).

Objective of the Study

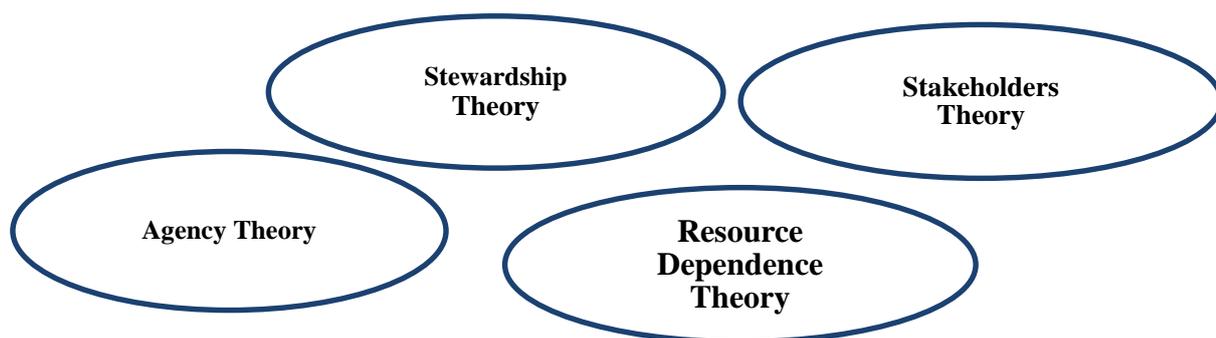
1. To identify various factors of Board Diversity and Corporate governance.
2. To empirically study impact of Board Diversity on Firm's Financial Performance.

Review of Literature

Various researches have resulted that how board of directors play there crucial role to postulate and make good corporate governance of their firm and how corporate governance effect the working of the firms.

Theories of Corporate Governance:

Corporate governance is analyzed with the help of various theoretical frameworks like:



Agency Theory

Agency theory defines the relation between the agents and principals. The agent is the representative of principal in a various business deals and is expected to represent the best interests of the principal as it is a very useful framework for developing governance body and controlling the working of organizations.

A board developed from agency theory tends to create an aura of strict management, superintendence also monitoring the performance of agent to safe guard the interest of the principal (Hillman & Dalziel, 2003). The board is actively concerned in providing fair and honest results which ultimately is responsibility towards their shareholders.

Mohammad Namazi (2012) analyzed the effective role control mechanism on agent in times of uncertainty by explaining that proper and strict control on agent will result into high profits which will be beneficial for principal and other parties which are directly or indirectly related to the organization. Fama and Jensen (1983) seek advice from such contracts as “internal rules of the game which specify the rights of each agent in the organization, performance criteria on which agents are evaluated and the payoff functions they face.”

Panda and Leepsa (2017) focuses on various problems occurring in agency cot and interest which emerges because of the partition of possession from control, diverse risk inclinations, data asymmetry and hazards related to morality which can be solved with the help of better and strong control of ownership, independence of board of directors, separate managerial ownership and forming different committees in organization which would control and monitor the working of organization.

Stewardship theory:

This theory explains the employee-oriented relationship between principal and the steward aka manager which should have a common aim of achieving profit and share in commonly where board of directors should be dominant (Davis, Schoorman, & Donaldson, 1997). The board ought to play an ancillary role by empowering executives and, in turn, increase the potential for higher performance (Shen, 2003). The theories argue for relationships between board and executives that involve coaching, mentoring, and shared deciding (Sundaramurthy & Lewis, 2003). It further advises that managers ought to incline autonomy supported trust that minimizes the price of observance and dominant behaviour of the managers and administrators. Andrew Key (2016) demonstrates that this stewardship theory grasps various factors like director's trust, their demonstrable skill, faithfulness and readiness to concern for the interests of others etc which is the underlying rule of governance body for the accountability of work done.

Resource-Dependence Theory

Resource dependency theory defined the idea that all the organizations are dependent upon external and environmental resources which are suppose to be utilized in limit and organizations should have proper plans and programs to use these resources in a proper way for their survival and not harming society.

Pfeffer and Salancik (1978) elucidates that the most important characteristics of environment is focus on environmental resources and the degree to which power and authority in the environment should be widely dispersed.

Daft (2006) explained that various resources of environment like assets, material, capabilities, attributes of firm, knowledge and information for environment and process of organization etc should be properly utilized and there should be proper strategies of organizations to recover them too so that it should not be dangerous for them and society itself.

Nienhüser (2008) explained that resource dependency theory can be utilized to clarify the authoritative procedures and structures to a specific degree in organization which can help them to safeguard the resources and protecting the environment.

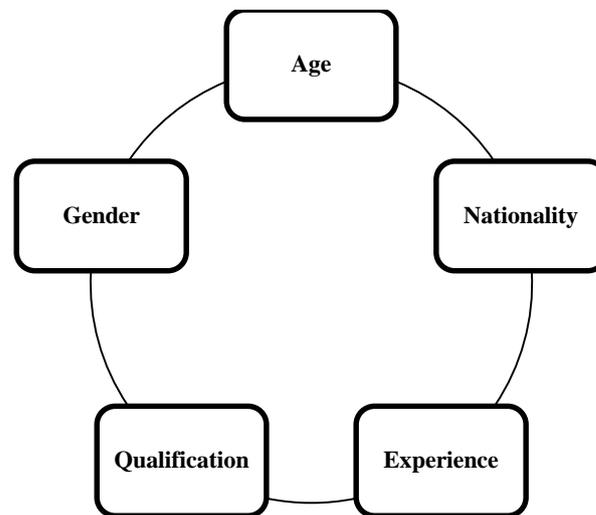
Stakeholder Theory

This theory focus solely on valuation creation of organization for their stakeholders which include customers, shareholders, government, suppliers, employees, communities etc. which should be aligned together in same direction. Freeman (2008) explained that the organization's utmost important role should be to maximize economic value for their stakeholders in order to gain good image and maximum stakeholders.

Antonio Argandona (2011) studied the role of stakeholder theory and explained that a organization should focus not only on one type of value to maximize the interest of stakeholders but also focus on other values like intrinsic values, economic extrinsic values, intangible extrinsic value, psychological intrinsic value, transcendent value etc. Carver and Oliver (2002) analyzed stakeholder's point of vision from non-financial outcome i.e. shareholders elucidates financial terms and stakeholders as in value for benefits “such as the satisfaction of pioneering a particular breakthrough, supporting a particular kind of corporate behaviour, or, where the owner is also the operator, working in a particular way”. Barney (2011) explained that there are few factors which should be focused in order to create better relation between stakeholder and the firm and these factors include stakeholder's utility related: goods & services, organizational justice, perceived opportunities costs, affiliation etc.

Meaning of Board Diversity:

Board Diversity is the breadth of prospective, not a mere inclusion of various diverse traits that will benefit the organization. Organizations believe that diverse board will enhance the quality of decision made by board members by utilizing different skills, qualification, experience, knowledge etc, which is necessary in achieving sustainable and balance growth. The role of board of director is very overwhelming as it tries to solve difficult responsibilities in organization. The board shouldn't just anticipate negative administration rehearses that may prompt corporate disappointments or outrages but also ensure that organizations but also improve the functioning by grabbing opportunities which leads towards firms betterment (Bathula, 2014). Board diversity has been broadly categorized into the following attributes:



Gender:

Gender is the most hot topic in every country and almost every organization. It is basically the existence of female and male on board. Gender equality is to be focused fully in order to bring balanced working ambience. Every country has mandated women in board room as per their corporate governance body. Pletzer et al. (2015) analyzed that existence of women as board of director in have very low impact on financial performance in organization and has been statistically uncorrelated.

Post and Byron (2015) studied 140 peer reviews of various countries and concluded that women on board are positively related to accounting based measures like return on asset and return on equity of firm's financial perform which helps to break the glass ceiling effect in society and valuing role of women on board. Letendre (2004) contended that women's attitude towards work and their communicating style is attractive and participative in nature as compared to male of board. Women have been given mere importance in firm which is helpful in improving the overall working of firm. Sonia Sharma (2014) explored the scenario of Indian firms in relation to Gender diversity and found that in India there is poor structure of women on board even after the mandate rules.

Renee B. Adams et al. (2009) empirically examined that gender diversity and firm performance has negative relation. The authors also found that women directors on board behave differently than men directors because as compare to female directors, there is less attendance of male directors on board. Women directors are more work-orientated and monitor the working of firms. It was found that women directors are more likely to attend meetings and monitoring related committees than men directors.

Age:

Age diversity is usually ignored in the boardroom but it is very important diversity factor which plays its role to describe the nature of working of directors in firm. Some board of directors are older who assert high level of experience and few directors are younger who are risk-takers, energetic, vibrant and up-to-date (Mishra and Jhunjhunwala, 2013). Haseeb Ur Rehman et al. (2014) studied the pre & post analysis of MCGG and measured the impact of financial performance on board diversity factors i.e. age and concluded that there was as such no impact of board of director's age on firm's financial performance.

Spakur Dagsson et al. (2011) analyzed that role and impact of age factor of diversity of the board members on the firm's performance and concluded that there is very positive and significant relationship between board of director's age and firms performance only in small firms and on the basis of Tobin's Q there was negative relationship between firms performance and age of board of directors in small firms but positive effect in Medium-sized and Large-sized firms. Ararat et al (2010) evaluated that there should be directors of different generations in firm which will bring advancement and new ideas and better decisions which will ultimately improve the working of firm and its financial performance

Nationality:

Nationality includes various factors like cultural background, socio-economic condition, overall aggregate personality which differs an individual from others as per nation. Manthos D. Delis (2015) studied panel of board of directors from firms of UK, North America of 1085 firms and concluded that hiring board of directors from different countries is very beneficial for firm's financial performance and flourished the overall working of firms.

Oxelheim and Randoy (2003) empirically studied the role of foreign directors and concluded that they play very important role in ensuring foreign investors to deal in firms they are working which will increase the investor's ratio and profitability of firm. Nationality diversity brings with it a profusion of experience and knowledge of various institutional and economic environments. Considering business activities frequently encompass the global economy, nationality diversification intersperses the understanding of different operating environments and their citizenship (Jhunjhunwala & Mishra, 2012), arguably intensifying competitiveness and company performance.

Nationality diverse teams support enhanced complex task solving and formulation of additional yet innovative solutions. Strategic decision making is epitomized by highly complex, uncertain and often unique situations in which nationality diversity undoubtedly intensifies the comprehension and quality of those strategic decisions resultant in shaping company performance (B.B.Nielsen & Nielson,2012).

Qualification

Board of director's qualification is pivotal for decision making and betterment of firm. Jose Elias Fere De Almeida et al. (2009) examined the qualities of board of directors especially focusing on qualification and concluded positive impact and

significant relation between qualifications of directors with firm's performance as board member are highly qualified in Brazilian firm. All the directors having higher degree and accountants on board have positive relation with firm's performance.

Hanoku Bathula (2008) empirically studied the relationship of qualification of board of directors and firms performance and concluded that there was negative and insignificant relationship of board members of PhD level qualification with firm's performance as qualification played no role in impacting firm's performance in New Zealand firms. Higher qualifications of board of directors ensured an effective board, which adhere high levels experience, sound judgment, intelligence in decisions and integrity (Hilmer, 1998). Mishra (2016) empirically studied the role and presence of women on board of 42 companies and concluded that the qualification of hired women directors is less. Greater portion is of postgraduate rather than doctorate. Author further suggested that Indian firms should hire more women on board who should motivate the working environment and bring new ideas.

Experience:

Having the ideal blend of aptitudes, ability and experience is fundamental to guarantee that the board members are prepared to control the business and overall system of the organization. Board of directors are regularly involved with administration and their role as experience individual matters deeply for firm. Li and Ang (2000) empirically studied the role of experienced directors and explained that directors are always needed for decision making of firm whether those decisions are small or big, there experience always prove them right and there demand is always higher for the betterment and long term running of firm.

Aldamen, et al. (2012) found that experience of board of directors is insignificant as their ideas were outdated and it was decreasing the overall performance of firm, it was suggested that directors with innovated ideas and young generation should be preferred. Güner, Malmendier and Tate (2008) elucidated that directors with experience in financial field impacts positively in providing funds from external resources which is beneficial for the firm but contrary to it it had no advantage for shareholders for the firm. Duc Vo et al. (2013) studied the relationship of firms performance and experience board of directors in vietnam and concluded that working experience of board of directors with firm performance i.e. directors in firms are intelligent and experienced having innovative ideas for the progress of firms.

Other Board Characteristics and Firm's Performance:

Board Meetings: Board meetings are used as a measure of intensity of board activity and a value relevant board attributes (Vafeas, 1999). The view that board meetings are a resource is reinforced by the criticism of directors who take up multiple directors and thereby limiting their ability to attend meetings regularly to monitor management (Byrne 1996; NACD, 1996). A clear implication of these studies is that directors in boards that meet frequently are more likely to perform their duties in accordance with shareholder's interests. Conger et al. (1998) suggest that board meeting time is an important resource in improving the effectiveness of the board. Board process has, therefore, tremendous impact on board task performance and effective meetings are essential for the successful performance of the board tasks (Zahra & Pearce, 1989).

Board Size

Board size the range of board of directors working in a particular organization. It is believed that each and every organization should have appropriate number of board size which brings best and its helpful for the growth of firm. Palanisamy Saravanam et al. (2012) attempted to study the impact of corporate governance with the manufacturing firms in India under BSE (Bombay Stock Exchange). Authors took sample size of 1732 companies and concluded that there is a significant relationship between board size and the performance of the firm.

Duc Vo et al. (2013) Overall study have only one negative result that board size in firms of Vietnam were small in size ranging in between 9 to 12 as compare to size of U.S. (between 15-20) which is not good for firm, so there is need to increase the size of board room, as higher the board members, higher were be sharing of ideas and control over the working of firms. Shelah Al- Harwery (2011) explains that role of proper board size will enhance the working of organization and will improve the board monitoring. Boone et al. (2007) found that board size depicts the quality of board and its working in supervising and monitoring the managerial system of firm and thus impacting positively the quality of the internal control.

Audit Committee:

Audit committee in every organization plays very effective and important role in monitoring the financial performance. The members of audit committee ensure that financial statements are true and there has been no fraudulence, this is the utmost important regulation of corporate governance body in every country for the firms.

Amer et al. (2014) examined the role of members of audit committee and concluded that there existence and monitoring of financial part of firm is very crucial and these committees should be formed in each and every firm. Baxter and Cotter (2009) explained that the size of members of audit committee should be bigger so that different financial expertise can provide best advice and better working can be ensured. Aldamen et al. (2012) examined that board members in audit committee in small number but experienced one are more effective and significantly related to the financial performance of the firm. Al-Matari (2013) studied the relationship of audit committee with company performance and was proved significantly positive because without audit committee it is dangerous to reveal the financial statement as chances of fraudulence can be there.

Firm Age:

It is the age of legal entities defined in years i.e. incorporation year of the firm. Majundar (1997) evaluated the impact age on firm's performance of 1020 firms in India and concluded that older organizations are productive in nature but there have less propensity of profit. Dogan (2013) examined 200 companies listed under Istanbul Stock Exchange for 5 years and concluded that there was no significant relationship between firm's and its overall performance especially the profitability.

Coad, Segarra and Teruel (2007) empirically studied Spanish firms for 8 years and concluded that value of firm increases with time as and when it is getting older but there has been improvement or increment in profitability of firm. Shumway (2001) explained the right way to calculate the age of firm i.e. age of firm since the incorporation should be considered.

Blau's Index of Board Diversity

Blau's index is a measure of diversity attributes like Age, Gender, Qualification, Nationality etc. The equation for Blau's index is $(1 - \sum p_k^2)$, here "p = proportion of group members in each of the k categories". Blau's index is computed as $(k-1) / k$. This index has been used in the organizational literature to measure diversity on a wide variety of attributes, including race, gender, functional background, education, and marital status (Harrison et al., 1998).

Bathula (2014) explained that diversity factors should be computed with the help of Blau's index in order to remove the inequality in the proportion or calculation of attributes when they are compared with other variables.

Impact of Board Diversity on Firm's Financial Performance:

Wicaksana et al. (2017) studied 238 companies under Indonesian Capital Market Directory (ICMD) for past 6 years. In this data the effect of board diversity with earning management was explored by using multiple regression and was found that they were negatively insignificant meaning thereby, higher board diversity lower was the earning management practices. Mishra (2016) empirically studied the role and presence of women on board of 42 companies under national stock exchange for two years i.e. 2013 and 2014 and concluded that the existence of women as board of director in Indian firms is very less as compared to other countries like USA, Canada, Norway, Singapore etc. The qualification of hired women directors are less. Greater portion is of postgraduate rather than doctorate. Author further suggested that Indian firms should hire more women on board who should motivate the working environment and bring new ideas. Gupta (2016) studied ROA (Return on Asset) of BSE 500 for the year 2009-2010 and 2014-2015 so that the role of independent directors can be clearly revealed. After applying paired sample t-test it was resulted that there was positive relationship of ROA with independent directors and this improved the overall performance of firm in 2015 than that of 2010. The ratio of increase in performance of firm is less which needs to boast up. Bansal et al. (2016) analyzed 235 non-financial Indian firms listed under NSE 500 for the period 2004 to 2013. After applying fixed effect panel data authors found mixed results in the variables. Board size had significant and positive effect on Tobin's Q and market capitalization of Indian firms. Audit committee meetings have insignificant influence on return of assets and negative effect on return of equity of firm. Audit committee had significant and positive effect with ROE but negative effect on ROA. There was a positive association of CEO duality with firms performance and finally major shareholding were found to be significantly positive in relation to return on equity. Sanan (2016) investigated the impact of gender diverse board in relation to financial and social performance of Indian firms by taking data of 54 companies listed under National Stock Exchange and Blau's Index was used to capture the gender diversity of the board and regression analysis was applied. Results did not find any significance difference between gender diversity and financial performance of firm (ROCE; Return on capital employed) and social performance which included corporate social responsibility score (CSRS). Wellalage et al. (2013) analyzed the effect of board diversity attributes like gender, age, ethnicity, education and occupation diversity on firm's financial performance. Sample of 198 Sri-Lankan companies listed under CSE for 4 years were studied and Blau's Index was used to measure board diversity and generalized method of moment (gmm) panel estimator and OLS regression was applied which have significant results. Board age and racial had positive effect on firm's performance with board diversity. On the contrary, board education, gender and occupation diversity had negative relation. Because of low presence of women on board financial performance was affected adversely and overall results were not up to desired goals.

Findings of the Study

1. Various studies have corporate governance have very prominent role in working of organization and without governance body it is impossible for a firm to survive in economy.
2. Diversity factors like Age, Gender, Nationality, Qualification etc are major contributors to reckon the efficiency of overall performance of the firm. These factors impacts both positively and negatively as per discussed reviews.
3. Theories of corporate governance are mandatory to be studied in depth in order to seek knowledge about the seek that why governance body should be strictly followed by organizations.
4. Impact of board diversity on corporate performance have shown mostly positive and significant results. Many other factors like board meeting, firm age, audit committee etc are usually counted as dummy variables but they do have huge impact on performance of firm.

Conclusion of the Study

Boards of Directors are the pillar for systems that guarantees that the interests of stakeholders and firm are aligned together by monitoring the working of firm as well. Gender, age, Nationality or independence of board etc are now a day's trending topic which should be studied deeply and mostly empirical research has been done on board diversity attributes and its relation with corporate governance. In this paper empirical study have been done by taking reviews of various authors on board diversity attributes and how corporate performance have been effected positively by solely following rules and regulations of corporate governance. The study have be extended across nation which can help to understand the different economic working, capital market, cultural differences, effectiveness of corporate governance body.

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