

**THE MODERATING IMPACT OF BOARD GENDER DIVERSITY
ON THE RELATIONSHIP BETWEEN SELECTED BOARD
ATTRIBUTES AND FINANCIAL PERFORMANCE IN LISTED
MANUFACTURING COMPANIES IN SRI LANKA**

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ABSTRACT

The main objective of this paper is to identify the moderating impact of the board gender diversity on the relationship between selected key board attributes and financial performance listed companies in the manufacturing sector companies in Sri Lanka. The sample of this study consists of 31 listed companies for the period 2012 to 2016 and secondary data was secured from their respective annual reports. The panel regression results indicate that board diversity has a significant moderating impact on the relationship between the board gender diversity on the relationship between selected key board attributes and financial performance. This key finding is expected to have significant policy implications.

Key Words: Corporate Governance, Board Characteristics, Financial performance, Board Diversity

1. Introduction

Generally accepted definition for corporate governance is stated as "the system by which companies are directed and controlled" (Cadbury Committee, 1992). The need for powerful corporate governance mechanisms mainly in corporations arises from the separation of ownership from control (Rankin et al, 2012). Although the fundamental agency problems in organizations have existed from the time of industrial revolution, the attention of the corporations and political leaders round the world turned into drawn afresh to the insidious nature of the concept of this conflict of interest as a result of agency problem, with the collapse of former energy giant, Enron. Different excessive-profile economic scandals and corporate collapses accompanied that of Enron with are, Parmalat, Lehman Brothers, and worldwide Crossing being a few of these that made headlines (Burnsed, 2009). Not only in developed countries, the arising number of corporate scandals are increasing when drown down to developing countries as well. Considering the Sri Lankan context Alpha Credit Card Company, Vanic Incorporation and the Golden Key Credit Card Company

(GKCC) are few to mention (Kalainathan et al., 2014). Due to the fact that evolving corporate scandals and issues regarding corporate governance aspect, arise the need to conduct a study in Sri Lankan context for further improvement in good governance aspects.

Extant studies (Gompers et al., (2003), Hassan et al., (2013), Suganya, J., & Lingsiya, K. (2017), Dissabandara (2012) find that board characteristics such as board independence, board size and meeting frequency to have a significant influence on the financial performance of the studies. On the other hand, Cartel et al. (2003), Byron, K., & Post, C. (2016), find that there is a moderating impact of gender diversity on financial performance of the firms. However, certain studies (Carter, D. A., D'Souza, F., Simkins, B. J., & Simpson, 2010, Protasovs, 2015) do not find such an impact. Motivated due to being in an era of empowerment, promotion of corporate success and prevention of corporate failures, availability of mixed evidence on gender diversity, the main objective of this study is to identify the moderating impact of the board gender diversity on the relationship between selected key board attributes and financial performance listed companies in the manufacturing sector companies in Sri Lanka.

The next sections of this paper is structured as follows: Section two presents a literature review on the main theories the study is based on and discuss the empirical literature on the study arena. Section three discusses the methodology used to address the identified research objective, conceptual diagram and the study variables. Section four presents the findings and discussions based on the data analysis using the quantitative research approach; and the final section provides the concluding remarks, and implications.

2. Literature Review

2.1. Corporate Governance and Board Diversity

Corporate governance is a broadly defined concept. According to the Cadbury Report (1992, p.14) 'Corporate governance is the system by which companies are directed and controlled', which is a generally cited definition. Alternatively, in line with Johnson et al. (2008), corporate governance is the structure and the system of control by managers who are accountable for the shareholders and stakeholders of the organization. The OECD (1999,P.9) defines corporate governance as a mechanism which 'entails a set of relationships between management, its board, its shareholders and other stakeholders' and states that 'corporate governance set the structure through which the goals and objectives of the organization could be accomplished , and means of attaining those through monitoring performance is determined. It further states that corporate

governance mechanisms are affected among parties who are involved in the governance system. The Controlling shareholders, which may be individuals, sub holdings, bloc alliances, or different corporations performing via a retaining organization or cross shareholdings, can drastically have an impact on corporate conduct' (p.10). For this reason, the OECD Code elaborates on shareholder rights, equitable treatment of shareholders, and the function of stakeholders in corporate governance and disclosure and transparency. The OECD definition can be considered a holistic and complete definition on corporate governance.

Through reviewing the current literature, it is evident that one of the principle issues connected with corporate governance is board diversity (Cartel et al. 2003, Alabede 2016). Moreover, the author came cross that, most essential element within corporate governance mechanism is the board of directors. Lindgren (2013) argued that, the board is a crucial part of all corporations and board of directors are the key leaders who directly involved in the directing and control of the organization. One of the main roles of board of directors are to lead the organization to reach its highest potential. As a consequence, board diversity plays more important function within procedure of good corporate governance (Cartel et al. 2003). The Board gender diversity (Mishra and Jhunjhunwala ,2013; Wellalage , 2011; Ujunwa, Nwakoby and Ugbam , 2012) is the number of female directors comprised on the board.

2.2. Resource Dependency Theory and Board Diversity

Resource dependency theory consider the strategic view of corporate governance. It demonstrates the way of managing required resources (with regards to external environment) and the organization to reach the set objectives (Hillman, Cannella & Paetzold 2000, Tricker 2012, Borlea & Achim 2013, Sonmez & Yildirim 2016). On the perspective of inter-organizational behavior, Pfeffer and Salancik (1978) argue that, in order to understand the behavior of the organization it is first important to identify and understand the context in which that behavior operates. It is clear from the perspective that organizational behaviors inevitably change with the environmental conditions wherein they operate (as stated in Borlea & Achim 2013 p.123). In line with Hillman, Canella and Paetzold (2000) that directors are a key resource of the organization, providing information, skills, access to key constituents such as suppliers, buyers, policy makers, social groups as well as legitimacy. The resource dependency theory helps boardroom diversity because it allows organizations link to the resources in the external environment (Rahman et al. 2014). Furthermore, the theory emphasizes the complex character of "network" concept underlying the corporate governance concept (Borlea & Achim 2013, p.124). As a consequence, the principle perspectives that, diversified corporate board is resource to any organization which will ultimately result in enhancing the financial performance.

2.3. Empirical Studies

2.3.1. Corporate Governance Mechanisms and Firm Financial Performance

Rashid and Islam (2013) and Jermias and Gani (2014) disclosed that a larger board size and CEO duality have been positively associated with company financial performance, however the findings are inconclusive. Andradi et al. (2017) found out that the CEO duality has a significant positive relationship through studying 100 listed companies in Sri Lanka. However, in that study board independence and financial performance has depicted a negatively insignificant relationship. Shank et al. (2013) discovered that large corporations perform better with systems and mechanisms of corporate governance. Bhagat and Bolton (2013) found board independence negatively related to ROA in the durations earlier than 2002, however was significantly positive after 2002. Bhagat and Bolton additionally found that the relationship between ROA with regard to board independence was significantly positive years following Sarbanes Oxley Act (Gompers et al., 2003). Results of the study conducted by Suganya, J., & Lingesiya, K. (2017) revealed that board size and independent board directors had significant relationship with ROA. Besides, board diversity and CEO duality were not significantly related to ROA. Gama and Rodrigues (2013) and Lan, and Ma (2014) determined the urge to commit accounting fraud and the probabilities of success in fraudulent acts are negatively related to the organization size and independence of the board. Sokolyk (2015) and Wang (2015) stated that effective corporate governance mechanisms lessen the opportunities and motives to commit frauds and thereby protect the goodwill and investor trust.

Other important controls to strengthen corporate governance systems are through committees, consisting of audit and compensation committees. Kajanathan (2012), revealed that the board committee and capital performance of the organization has a significant effect on the firm capital structure. Jermias and Gani (2014) stated that the scale of the audit committee and the variety of board meetings have been negatively associated with the organization financial performance. Adewuyi and Olowookere (2013) disclosed that independence of the audit committee significantly positively related to ROA and Tobin's Q ratio. Ioana and Mariana (2014) stated that the frequencies of audit committee meetings or board meetings are not significant with regard to financial performance. However, members know how and expertise in financial data analysis significantly and positively associated with ROA. Return on Assets is a generally accepted financial measures of an organization. Return on Assets is used because it is the ratio of earnings before interest, tax, depreciation and amortization (EBITDA) and determine all assets of the company (Poutziouris et al., 2014). Return on Assets has been used to measure financial overall performance in many research studies in the same field (Muttakin et al., 2016).

Tobin's Q ratio turned into named after the great James Tobin, the Yale college Nobel Prize winner in economics who stated that the cost of replacement of a company's assets is set the identical cost as its market value. In other words, the formula for Tobin's Q ratio is the total market value of the organization divided by the total asset value of the firm. Any value of the Q ratio above one means the firm is efficiently utilising its assets and should buy more to growth shareholder's wealth. A ratio less than one indicators to control or a predator that the company is undervalued and a candidate for a takeover (Lasisi, 2017). Tobins Q ratio forms an overall performance metrics comprise beneficial statistics regarding marketplace power, profitability, and efficiency (Lasisi, 2017).

The age of the firm is a proxy for experience. An older firm ought to be able to withstand better intense economy shocks and changes than a new company. The age of the organization will also be a point of attraction for personnel including employees who see older company as secure and constant, and a place to construct careers on an extended-time period. In this study, the age of the firm is measured considering number of years since incorporation.

2.3.2 Board Diversity as a Moderator

The current literature also shows that diversity in the board has a tendency to generate higher creativity, innovation and effective decision making at individual and group levels, as board functioning is to a high extend associated with organizational performance (Fondas,2000).One often recommendation is to increase the number of female directors on board (Catalyst, 2011; credit Suisse, 2012; Ernst & young, 2013), primarily based on the idea that the experience and values of female directors may impact on the corporate governance attributes and reputation (Adams, Haan, Terjesen, & Ees, 2015; Terjesen, Sealy, & Singh, 2009). but, the results from empirical studies analyzing a probable link between board gender diversity and corporate governance attributes and organizational performance are mixed, where some studies found a positive impact (e.g., submit, Rahman, & Rubow, 2011; Skaggs, Stainback, & Duncan, 2012); whereas the others found a negative or null impact (e.g., Rao, Tilt, & Lester, 2012; Rodriguez-Dominguez, Gallego-Alvarez, & Garcia-Sanchez, 2009). Therefore, the question arises with regard to whether increased gender diversity on boards has an impact organizational financial performance.

Reviewing the literature, it is evident that there are mixed arguments and inconclusive findings on the relationship between the selected attributes of the board characteristics and the financial performance of the organization and also on the moderating impact of board gender diversity between the selected board attributes and organization financial performance.

3. Methodology

As indicated under the introduction to the study, the main objective of this study is to examine the moderating impact of the board gender diversity on the relationship between selected board characteristics and firm financial performance. Thus, since the study examines the relationships, a quantitative approach is deemed appropriate and utilized. Furthermore, a similar approach is used under studies such as Oconnel and Cramer (2010) and Ujunwa (2012).

The population of this study consists of listed manufacturing companies in the Colombo Stock Exchange (CSE), and 33 listed manufacturing firms were selected out of 39 companies for a period of 5-year period from 2012 to 2016. Some companies had to be omitted due to non-availability of data, but it was examined and confirmed that a bias is not created due to such omission. Finally, 152 firm-years (for 33 companies) were secured for the purpose of this study. Both the corporate governance, financial performance and other related data was collected from annual reports accessed via the CSE website.

The conceptual diagram drawn based on the extant literature performed is depicted in Figure 1 below.

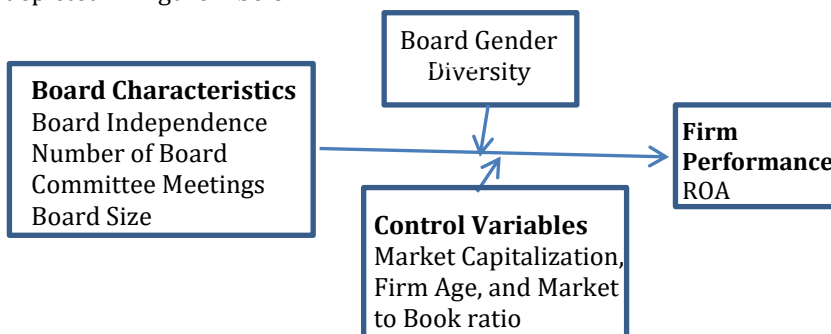


Figure 1: Conceptualization Diagram

Source: Author constructed

Based on the conceptual diagram depicted above, the following hypotheses are developed:

- H₁: Independence of the board has a positive association with firm financial performance
- H₂: Number of board committee meetings has a positive association with firm financial performance
- H₃: Number of directors on the board has a positive association with firm financial performance
- H₃: Board gender diversity has an impact on the relationship between board governance characteristics and firm financial performance

Table 1: Operationalization of Variables

Variable and Denotation	Measurement
Board Independence (<i>BInd</i>)	Measured by dividing the number of independent non-executive directors by the total number of board of directors in firm <i>i</i> period <i>t</i> .
Number of Board Meetings (<i>Bmet</i>)	Number of board meetings conducted during the period <i>t</i> for firm <i>i</i> .
Board Size (<i>Bsiz</i>)	Total Number of directors entailed in the board for period <i>t</i> for firm <i>i</i> .
Board Diversity (<i>Divr</i>)	Denoted as “1” and “0”, if the board consists of female directors then it is denoted as “1” and “0” otherwise.
Return on Assets (<i>Roa</i>)	Profit before tax and interest divided by total assets of firm <i>i</i> period <i>t</i> , which is expressed as a percentage.
Market to Book value (<i>MtoB</i>)	Total market value divided by the total assets value of firm <i>i</i> period <i>t</i> .
Firm Age (<i>Age</i>)	Age of the company (age since incorporation) of firm <i>i</i> period <i>t</i> .
Natural logarithm of market capitalization (<i>LnMktCap</i>)	Natural logarithm of market capitalization of firm <i>i</i> period <i>t</i> .

Source: Author Constructed

In terms of the analysis, first the data was screened and cleaned for any missing data and outliers, and the relevant analyses did not indicate the availability of such. Further diagnostics on normality, linearity, multicollinearity and heteroskedasticity were performed and no significant issues were discovered. In order to obtain an idea on the data, descriptive statistics such as mean, standard deviation, minimum and maximum values were generated. Then, a Pearson's correlation analysis was performed to obtain an idea on the relationships between the financial performance of the firm and other variables on a bivariate basis. Finally a panel regression analysis was performed in order to identify the relationship between the financial performance and selected corporate governance variables as well as to examine the moderating effect of board diversity (Hausman test was performed to test the fixed and random effects, and the results suggested to use fixed effects). For this purpose, the following regression equation is suggested and tested (the definitions of the variables are indicated in Table 1 above):

$$ROA_{i,t} = \alpha + \beta_1 BInd + \beta_2 Bmet + \beta_3 Bsiz + \beta_4 Divr + \beta_5 MtoB + \beta_6 Age + \beta_7 LnMktCap + \beta_8 BInd * Divr + \beta_9 Bmet * Divr + \beta_{10} Bsiz * Divr + \varepsilon$$

The results obtained via these analyses are discussed next.

4. Results, Analysis and Discussion

In this section, the results obtained by performing the suggested analyses in the preceding section is presented. First, in order to describe the data, the descriptive statistics will be presented. Then, the correlation and panel regression results will be presented.

Descriptive statistics on the main variables used in this study is presented in Table 1 below. The results indicate that the Return on Assets (*Roa*) is merely 3.87%, which is not that much high. The ratio between non-executive directors (*Blnd*) to total directors 31.7%, which means that approximately one third of the boards consists of non-executive directors and this observation is consistent with the minimum stipulated corporate governance best practices in the Sri Lankan context. The descriptive statistics on board meetings (*Bmet*) indicate that the boards had met on average five times a year. On the other hand, the average board size is eight directors. In terms of diversity (*Divr*), it is quite encouraging to observe that approximately 73% of the boards have at least one female director in their respective boards.

Table 2: Descriptive Statistics

Variable	Obs	Mean	Std.Dev.	Min	Max
<i>Roa</i>	152	3.867	2.998	.011	13.16
<i>Blnd</i>	152	.317	.102	.143	.5
<i>Bmet</i>	151	5.291	2.948	1	12
<i>Bsiz</i>	151	7.921	2.317	4	14
<i>MtoB</i>	152	.462	1.353	0	8.66
<i>LnMktCap</i>	152	21.217	1.49	18.447	23.922
<i>Age</i>	152	42.184	32.086	10	169
<i>Divr</i>	152	.743	.438	0	1

The Pearson's correlation results, which highlights the relationships between the key variables of the study are presented in Table 3 below. It is quite surprising to see that there is a statistically significant ($p < .05$) negative relationship between board meetings held during the year and return on assets.

In the preceding section, under hypothesis H₂, it was hypothesized that there is a positive relationship, and the result under the correlation result does not support it. Similarly, although under the resource dependency theoretical perspective, a positive association between the board gender diversity and return on assets could be postulated, there is a statistically significant negative relationship is noted. As explained under empirical literature, this situation might be due to the risk aversion of female directors within the boards. Furthermore, the results indicate that board independence and the board size

do not have a significant association with the return on assets, which are also contrary to the hypothesized associations of the preceding section.

Table 3: Correlation Analysis

	<i>Roa</i>	<i>Blnd</i>	<i>Bmet</i>	<i>Bsiz</i>	<i>Divr</i>	<i>Tobi</i>	<i>LnMktCap</i>	<i>Age</i>
<i>Roa</i>	1							
<i>Blnd</i>	-0.01	1						
<i>Bmet</i>	-0.21**	-0.32***	1					
<i>Bsiz</i>	0.09	-0.12	0.23***	1				
<i>Divr</i>	-0.19**	0.10	-0.11	0.26***	1			
<i>MtoB</i>	-0.23***	-0.06	0.14*	0.05	0.19**	1		
<i>LnMktCap</i>	0.35***	-0.10	0.15*	-0.02	-0.23***	-0.10	1	
<i>Age</i>	-0.18**	0.10	0.15*	-0.04	-0.05	0.15*	-0.24***	1

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

The results of the panel regression analysis with regard to *Roa* is depicted under Table 4 below. When considering the relationship between the selected dimensions of board characteristics and return on assets, it could be observed that there is a significant ($p < .10$) positive relationship between board meetings and return on assets (*Roa*), which supports the hypothesis, H₂. On the other hand, board size has a significant negative relationship with return on assets (*Roa*), and board independence (*Blnd*) has no systematic relationship with *Roa*, which is quite unexpected. Furthermore, it is noted that board diversity and return on assets does not depict a statistically significant relationship.

Table 4: Panel Regression Results

<i>Roa</i>	Coef.	St.Err.	t-value	p-value	[95% Conf	Interval]	Sig
<i>Blnd</i>	-2.645	3.319	-0.80	0.427	-9.225	3.934	
<i>Bmet</i>	0.353	0.196	1.80	0.074	-0.035	0.741	*
<i>Bsiz</i>	-0.721	0.378	-1.91	0.059	-1.471	0.028	*
<i>MtoB</i>	-0.110	0.136	-0.81	0.420	-0.381	0.160	
<i>LnMktCap</i>	0.656	0.131	5.02	0.000	0.397	0.915	***
<i>Age</i>	-0.001	0.101	-0.01	0.994	-0.202	0.200	
<i>Divr</i>	4.769	3.472	1.37	0.172	-2.114	11.651	
<i>Blnd</i> × <i>Divr</i>	-17.302	5.047	-3.43	0.001	-27.305	-7.299	***
<i>Bmet</i> × <i>Divr</i>	-1.847	0.305	-6.05	0.000	-2.452	-1.242	***
<i>Bsiz</i> × <i>Divr</i>	1.233	0.442	2.79	0.006	0.356	2.109	***
Constant	-5.248	6.057	-0.87	0.388	-17.254	6.758	
Mean dependent var		3.853			SD dependent var	3.004	
R-squared		0.445			Number of obs	151.000	
F-test		8.666			Prob > F	0.000	
Akaike crit. (AIC)		558.872			Bayesian crit. (BIC)	592.062	

*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

On the other hand, all the interaction terms between selected governance mechanisms and board gender diversity (i.e., *Bind* × *Divr*, *Bmet* × *Divr* and *Bsiz* × *Divr*), which indicate the moderating impact, have a significant relationship and thus could be claimed that board gender diversity moderates the association between the selected corporate governance mechanisms and firm financial performance, and thus the hypothesis H₃ is supported.

Through the literature review, it was evident that even though there have been numerous studies conducted with regard to concepts in corporate governance, there are contradictory views on the findings and discussions. In line with Palaniappan, 2017 and Georgeta et al, 2012, this study found out that there is no statistically significant relationship between board independence and the selected organizational financial performance measures. Bhagat et al. (2002), mentioned that it could be due to the reason that outside directors may lack with the knowledge regarding organizational affairs and interest to achieve the pinnacle in terms of monetary values. In line with Imam and Malik, 2007, Board size does not have a statistically significant relationship with selected measures of financial performance. Even though larger boards tend to have a greater diversity of experiences, necessary management abilities and capacity for exceptional advice, larger boards are at risk of the issues of coordination which can also lessen organizational financial performance (Lasisi, 2017).

The findings show that there is a statistically positive significant relationship between the number of board meetings and return on assets (ROA). Whilst the finding that number of board meetings are statistically significantly positively associated with return on assets provides support for the recommendations of King IV report on corporate governance (2016) that corporate boards should at least meet four times in a year.

Principle no.7 of the King IV report on corporate governance (2016), p.54 states that the governing body should comprise the appropriate balance of diversity aspect and discharge the governance role, and responsibilities effectively. However, through the findings it is evident that there are several grounds for anticipating that the market reaction to female directors will be unfavourable, resulting in a negative impact on financial performance. Most societies view ladies in top managerial positions unfavourably (Hofstede, 1998), and these perspectives are suggested on the focus of board positions which can be related to power, authority, and control attributes which might be decidedly masculine. The poor views of female directors on boards are probable to be marked in emerging markets, shaped via deeply rooted destructive attitudes for women in positions of power (Abdullah, S. N., Ismail, K. N. I. K., & Nachum, L. (2016). Further, the low participation of females on boards reduces and can eliminate precedents on which to evaluate the possibly final outcome of their presence.

This will increase the perceived risk related to their nominations, which can be consequently discounted by risk averse investors (Lubomir, Moreton, and Zenger, 2012).

As noted, number of female directors on boards in emerging markets are scarcer than in developed nations (GMI, 2013), and this scarcity highlights the risk associated with their nominations. The unfavourable social perception towards female directors on board in an emerging economy like Sri Lanka is highly affected by the risk averse tendency of investors due to the reason that investor protection is usually weak (Wellalage, N. H., & Locke, S. (2013). Female directors are nominated as a token and in a male dominated culture is very likely to make female directors a silent representative of the board. The same result in conflict of interests and will lead in increasing agency costs in countries like Sri Lanka because of high uncertainty markets (Wellalage, N. H., & Locke, S. (2013). Another reason for this statistically significant negative moderate effect could be inactive representation of women in Sri Lankan companies. More than 64% Sri Lankan listed corporations are family businesses (Masulis et al. 2009) and there is a trend where the founder includes family members on the board in order to increase the size. Sri Lankan women are principally caregivers for their family and it is evident that they give priority to the family and household duties encouraged by the masculine or patriarchal corporate culture (Tudawe (2010). The same could lead to make them silent representatives of the board (Wellalage, N. H., & Locke, S. (2013). Another reason could be even though females in Sri Lanka, women have equal access to education at any degree, it has been suggested that they are not efficiently empowered to gain the industrial exposure thoroughly compared to males which in result limit their practical industrial competencies (Wellalage, N. H., & Locke, S. (2013).

5. Conclusion

The main objective of this study was to examine the impact of board gender diversity between board attributes and financial performance of the selected listed manufacturing sector organization in Sri Lankan context. Our findings make important contributions to the theory and practical implications on ways to enhance the effectiveness of female directors of board and also to enhance the organization financial performance through insights and effective decision making attained through board meetings. The implications of our evidence suggests that corporations can schedule board meeting arrangements that are both flexible and responsive to the business environment that the organization operates. Through board meetings pool of ideas and knowledge expertise can be shared and thereby will result in effective decision making. To enhance the female directors' contribution as a director in the board government and education authorities could introduce more industrial on the job training opportunities to develop their practical knowledge essential for effective

management of the organization. Moreover, valuable social problems arising of family ties and as a solution flexible working arrangements are often provide more opportunities to enhance women active participation on board and to give their contribution. Government policies should be formed with recognition with the factors affect the contribution of female directors and the limitations. Firms considering the nominations of women to their boards should also be aware of it. The firm specificity also need to be focused for nuanced responses to female representation on board nominations from organizations and policymakers.

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