

## **The Moderating Effect of Women Directors on Board of Directors and Firm Performance: A Narrative Review**

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### **Abstract**

A competent board of directors (BOD) is one of the firm's resources to attain competitive advantage of a firm. It impacts firm in different perspectives including firm performance. BOD diversity is a subset of board composition. It is a key factor of firm performance as women directors enhance BOD function in multiple approaches. Nonetheless, majority of the previous studies were focused on the direct relationship between women directors and firm performance without the consideration of its moderating effect. This paper proposes a need to initiate another study to address the knowledge gap by examine the moderating effect of women directors on the relationship between BOD and firm performance. This conceptual paper discusses from the point of academic and professional perspectives. Academically, it could verify the preference of developed countries in employing women force to improve firm performance. Besides, it could address the controversial view of the way how women directors enrich BOD function since they are a key element in governance. In additional, scouting the moderating effect of women directors between BOD and firm performance could contribute a novelty since existing evidence are scare and incomprehensive. Professionally, this paper will provide valuable insight to policy makers in drafting Corporate Governance guideline in future for the best interest of both company itself and country's economic prosperity as a whole. Moreover, it could also supply valuable insight to nomination committee in recruiting new member especially female member to revamp firm performance. Finally, it could serve as an extra consideration to investor in making economic decision as it could increase the possibility of a desirable investment return.

**Keywords:** Agency Theory, Board of Directors, Corporate Governance, Firm Performance, Women Directors

### **Introduction**

Annual Global Ethics Day came to its 6<sup>th</sup> anniversary in October 2019 (Carnegie Council, 2019). Over the past few decades, ethic education and studies has been preaching across the globe (Andersen & Klamm, 2018; Miller & Shawver, 2018; West & Buckby, 2018). Therefore, theoretically corporate scandals such as bribe, corruption fraud, and earning management should be minimized. However, rules and regulation proved its necessity with the outbreak of the infamous corporate scandals throughout the history. Among them are Enron Corporation which caused \$74 billion losses to its shareholders in year 2001, Worldcom which caused \$180 billion losses to its investors in year 2002, Lehman Brothers which disguised \$50 billion in loan as sales in year 2008 and went bankruptcy

at the end. All these financial scandals deteriorated firm performance on top of brought huge losses to investors.

Consequently, corporate governance (CG) research appears as a key research topic among researchers. Commonly, CG has been defined as “The system by which companies are directed and controlled” (Cadbury, 1992, p.15). It boosts economic growth with the underpinning value of accountability, ethically and transparency (Bursa Malaysia, 2017). It includes several monitoring mechanisms (Nyatichi, 2017). Among them, Board of Director (BOD) is a significant CG attribute to combat agency cost, a conflict of interest between the manager and the owner of the firm (Jensen & Meckling, 1976).

BOD is the highest authority to plan, determine and monitor the strategic direction of a firm (Fama & Jensen, 1983). A competent BOD is also one of the firm ‘s resources to attain the competitive advantages to firm (Barney, 1991). BOD contributes to the firm in various ways. Among them are advice task (Westphal, 1999), control task (Daily, Dalton & Cannella, 2003), networking task service task (Åberg, 2019), and (Hillman & Dalziel, 2003), strategic participation task (Pugliese, Bezemer, Zattoni, Huse, Van Den Bosch, & Vol, 2009). Moreover, past studies showed BOD influences firm performance in various manners (Saidat, Silva, & Seaman, 2019; Jubilee, Khong, & Hung, 2018; Bhatt & Bhatt, 2017; Low, Roberts, & Whiting, 2015).

BOD diversity, a subset of board composition is a key factor of firm performance (Green & Homroy, 2018; Jubilee et al., 2018; Low et al., 2015; Scholtz & Kieviet, 2018; Solakoglu & Demir, 2016). Hitherto, the effect of women directors against firm performance has been investigating thoroughly (Hewa Wellalage, 2013) with different results (Post & Byron, 2015). Most of them proved gender diversity was significant positively associated with firm performance (Green & Homroy, 2018; Jubilee et al., 2018; Scholtz & Kieviet, 2018; Low et al., 2015; Perryman, Fernando, & Tripathy, 2016; Solakoglu & Demir, 2016; Post & Byron, 2015) along with other findings suggested either small (Konrad, Kramer, & Erkut, 2008), insignificant ( Shukeri, Shin, & Shaari, 2012; Carter, D'Souza, Simkins, & Simpson, 2010), none (Pletzer, Nikolovo, Kedzior, & Voelpel, 2015), mixed (Abdullah, Ismail, & Nachum, 2016) and even negative ( Ahern & Dittmar, 2012; Adams & Ferreira, 2009) relationship between women directors and firms performance.

Notwithstanding that, most of the past studies paid much attention on the direct relationship between board characteristics and firm performance in the absence of the moderating effect caused by women directors (Shan, 2019; Mishra & Kapil, 2018; Palaniappan, 2017). Thus, the outcome of the moderating effect of women directors toward board characteristic and firm performance are scarce and incomprehensive. Among them are the relationship between CEO ‘s remuneration and firm performance be strengthened (Usman, Farooq, Zhang, & Dong, 2019), the negative relationship between political connected firms and cost of debt be strengthened (Tee, 2019), no influence on the relationship between earning management and firm value (Anjelina, 2019), moderation on the relationship between family management and indebtedness (López-Delgado & Diéguez-Soto, 2018) and moderation of executive remuneration growth (García-Izquierdo, Fernández-Méndez, & Arrondo-García, 2018). Therefore, this paper proposes a need to initiate another study to address the knowledge gap by examine the moderating effect of women directors on the relationship between BOD and firm performance.

The following discussion relook at the previous works on BOD, firm performance, and women directors in CG

## Literature Review

### *Agency Theory and Board of Directors*

Agency theory is commonly quoted in CG researches (Fama & Jensen, 1983). It recognises the separation of ownership and control (Jensen & Meckling, 1976). The underpinning principle is the conflict of interest between the owner, shareholders and the agent, management. It happens as owner expects for profit maximization whereas management does not honor it but to set personal goal such like job security and status at the first place. Conflict of interest also takes place after different risk appetite between these parties. Generally, management possess lower risk appetite to secure their office and welfares granted whereas shareholders possess higher risk appetite as they can diversify their risk by invest in different firms (Wiseman & Gomez-Mejia, 1998).

Conflict of interest gives rise to the managerial opportunism risk. It occurs when management entrench themselves by initial those contracts which they are comfortable with instead of those which is best in terms of profit making to safeguard their position (Shleifer & Vishny, 1989). Some also committed in earning management in real activities manipulation. Among them were carried out year-end sales to boost revenue or overproduction to lower cost of sales and delayed discretionary expenditures to demonstrate a stronger financial performance (Roychowdhury, 2006), hosted major corporate exercises such like Initial Public Offering (IPO) or Seasonal Equity Offering (SEO) (Teoh, Welch, & Wong, 1998) as well as Mergers and Acquisitions (M&A) (Erickson & Wang, 1999). All these activities left shareholders' goal of profit maximization in jeopardize.

Agency Theory supports management monitoring as the crucial role played by BOD on behalf of the owner (Hillman & Dalziel, 2003). A diversify BOD with the inclusion of women directors is an effective CG mechanism for management monitoring (Bhojraj & Sengupta, 2003). It is because women directors are keen to challenge the decision made in comparison with a BOD without women directors (Carter, 2003). Furthermore, a diversified board contributed to agency problem mitigation by pay more dividend to reduce free cash flow (Byoun, Chang, & Kim, 2016).

### *Firm Performance*

Firm performance should be measured appropriately to guarantee a long term competitive advantage (Yıldız & Karakaş, 2012). Thus, strategic management required performance measurement knowledge as the underpinning foundation (Silvestro, 2014). Firm performance can be measured both financially and non-financially.

There are numerous non-financial performance measures. For example, product quality, customer satisfaction and market share. Nowadays, they attract more researchers to carry out relevant study since these measures were found to be significantly associated with financial performance in long run provided comprehensive performance base remuneration packages are in place (Banker, Potter, & Srinivasan, 2000).

Nonetheless, financial performance measurement is still the conventional method exercised by most management even though there are many non-conventional performance measurements be introduced up to date (Tangen, 2004).

Financial performance measurement can be exercised in both objectively and subjectively (Yıldız & Karakaş, 2012). Objective and subjective measurement are positively collated with each other (Wall, Michie, Patterson, Wood, Sheehan, Clegg, & West, 2004) and are accepted among managements to measure the performance (Vij & Bedi, 2016). The indicators of objective measurement are Return on Asset (ROA), Return on Equity (ROE) and Tobin's Q ratio whereas the subjective measures are profitability, launch of new product and market share (Yıldız & Karakaş, 2012).

### ***Board of Directors and Firm Performance***

BOD is the highest authority of a firm. It ultimately accountable for firm's performance. In terms of CG, it is an inner mechanism which is capable to enhance management monitoring (Bhojraj & Sengupta, 2003). A qualified BOD is also a firm's resources to attain competitive advantage among the market players (Barney, 1991). It design, implement and monitor the strategy of firm with their expertise and experiences (Fama & Jensen, 1983).

As a result, BOD could influence firm performance in many ways. Among them are corporate social responsibility (Sheela et al., 2016) and disclosure (Hussain, Rigoni & Orij, 2018; Omar & Amran, 2017), debt composition (Hussain, Ali, Thaker, & Ali, 2019) earning management (Abdullah, et al., 2018; Abdullah & Ismail, 2016), financial performance (Saidat, et al., 2019; Jubilee et al., 2018; Bhatt & Bhatt, 2017; Low et al., 2015), financial stability (Lassoued, 2018), investment (Badru et al., 2019), risk management (Poletti-Hughes & Briano-Turrent, 2019; Sanusi et al., 2017), stock market liquidity (Amer, Hussein, & Ali 2017), sustainability (Hussain et al., 2018), and tax aggressiveness (Kim & Zhang, 2016).

### ***Women Directors and Moderating Effect***

Men and women are born with different inner value naturally (Adams & Funk, 2009). Thus, they behave differently on same issue (Croson & Gneezy, 2009; Schmitt, Realo, Voracek, & Allik, 2008; Costa, Terracciano, & McCrae, 2001). The differences include risk appetite (Charness & Gneezy, 2012; Croson & Gneezy, 2009), investment preference (Eckel & Grossman, 2008), ethical value (Ruegger & King, 1992), openness (Byrnes et al., 1999), self-confidence (Levi, Li, & Zhang, 2014), information management capability (Darley & Smith, 1995), mercy (Williams, 2003) and power orientation (Adams & Funk, 2009). As a result, gender matters in performance management as men and women perceive differently from both economy and psychology perspectives (Rossi, Hu, & Foley, 2017).

Nowadays, women directors are perceived as a valuable input of corporate governance (Terjesen, Sealy, & Singh, 2009). For example, the report of Catalyst (2018) pointed that developed countries has been leading in employing women directors. Among them are France (44.3%), Netherland (34%), United Kingdom (31.7%), Australia (31.2%) and Canada (29.1%). Indeed, numerous researches proved women directors contribute to firm performance in multiple approaches (Hoobler et al., 2016). Among them are evaluate board function frequently (Nielsen & Huse, 2010), enhance earning quality (Srinidhi, Gul, & Tsui, 2011), reduce acquisition premium (Levi, 2014), various speciality (Hillman, 2000, 2007) and well equipped (Pathan & Faff, 2013). These unique characteristics are able to mitigate agency cost (Reguera-Alvarado, de Fuentes, & Laffarga, 2017),

In view that women directors influence BOD significantly, women directors are posited that they could moderate the relationship between board characteristic and firm performance. In fact, most studies acknowledged a gender-balance board enriched BOD function (García-Izquierdo et al., 2018). Moreover, several studies have demonstrated the moderating effect of women directors in different perspectives. For instance, it strengthened the relationship between CEO 's remuneration and firm performance (Usman, Farooq, Zhang, & Dong, 2019), strengthened the negative relationship between political connected firms and cost of debt (Tee, 2019), brought no influence on the relationship between earning management and firm value (Anjelina, 2019), moderated the relationship between family management and indebtedness (López-Delgado & Diéguez-Soto, 2018) and moderated executive remuneration growth (García-Izquierdo et al., 2018). Consequently, it warrants an additional study on the moderating effect of women directors on the relationship between BOD and firm performance.

### Conclusion

A competent BOD is one of the firm's resources to attain competitive advantages of a firm. It impacts firm in different perspectives including firm performance. BOD diversity is a crucial factor to be considered when forming a board as women directors could contribute to BOD significantly.

Nonetheless, majority of the previous studies were focused on the direct relationship between women directors and firm performance without the consideration of its moderating effect. Thus, it warrants an additional study to overcome the knowledge gap, specifically the moderating effect of women directors on the relationship between BOD and firm performance.

The proposed study is significant academically and professionally. Academically, it could verify the preference of developed countries in employing women force to improve firm performance through introduction of women directors on BOD as the weighting are noticeable recently.

Furthermore, it could address the controversial view of the way how women directors enrich BOD function since they are a key element in governance (Carter et al., 2010; Farrell & Hersch, 2005) In additional, scouting the moderating effect of women directors between BOD and firm performance could contribute a novelty since existing evidences are scare and incomprehensive.

Professionally, this study will provide a valuable insight to policy makers in drafting CG guideline in future. For instance, the need of a gender-balance board could be further strengthened by embody it within next version of companies act to catalyse the participation of women directors on BOD for the best interest of both company itself and country 's economic prosperity as a whole.

Moreover, it could supply valuable insight to nomination committee in recruiting new member especially female member. They could make women a priority option when finalizing new member for existing masculine BOD so the firm could enjoy the benefits of having women directors which is never available before. In other words, gender could be incorporated within current evaluation criterion on top of those conventional requirements such as education, specialty, and awards earned to revamp firm performance.

Finally, it could serve as an extra consideration to investor in making economic decision. Specifically, they could look at the target firm's BOD composition prior

exercise investment decision making. Preference could be given to gender-balanced board firm while other conventional investment benchmarks such as earning per share, price-earnings ratio and earning yield remain applicable as it could raise the possibility of a desirable investment return.

Nevertheless, the proposed study may come with two limitations which are noteworthy that could be further addressed by future study. Firstly, regression model is the standard approach to identify the moderating effect. Unfortunately, generally it is unable to account all variables which could influence the dependent variable in its own way. In other words, there could be a few of independent variables which failed to be incorporated into the regression model. Therefore, future research could try to increase the number of relevant independent variable over studies to complement the evidence.

Apart from that, the proposed study is most likely to be a quantitative casual research. A quantitative casual research could identify the moderating effect appropriately and provide a valuable empirical evidence. Nonetheless, neither it could elaborate the cause of the effect nor picture the interaction mechanism which are also significant in management strategy improvement. Thus, future research could be done in qualitative approach which employs substantial primary data to contribute unique insight in depth. For example, it could interview relevant stakeholders such like policy maker, regulator, senior management and experienced investor for the nuanced view from various perspectives.

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