DIVERSITY MANAGEMENT IN CORPORATE BOARDS AND ITS IMPACT ON SUSTAINABLE FINANCIAL PERFORMANCE

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Abstract

In light of the numerous global crises currently unfolding, the importance of effective diversity management within board structures has grown significantly. This study explores how diversity management in corporate boards impacts sustainable financial performance. Recognized as a critical factor in building investor confidence and engagement, effective diversity management not only helps mitigate risks, but also protects investor rights. The quantitative research paradigm has been employed to assess the impact of diversity management on sustainable financial performance. Diversity management, encompassing dimensions such as gender, nationality, and political affiliation, is considered the independent variable. To account for additional influences, firm size, and leverage are included as control variables. The analysis is conducted using a range of econometric and statistical tools, including descriptive statistics, variance inflation factor analysis, correlation analysis, heteroscedasticity testing, and regression analysis. The study's results indicate that gender diversity and political affiliation diversity positively influence sustainable financial performance, while nationality diversity appears to have a negative effect on long-term financial sustainability. Categorizing diversity provides a framework for enhancing board decision-making, which can significantly impact sustainable financial performance. Additionally, in developing economies, diverse boards have the potential to drive transformative changes that contribute to long-term financial sustainability.

Keywords: Diversity Management, Gender Diversity, Nationality Diversity, Political Affiliation Diversity, Sustainable Firm Performance

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1. INTRODUCTION

Diversity management is typically integrated through policies and practices designed to handle diversity effectively within corporate boards. The primary goal is to ensure equal opportunities for all groups, whether minority or majority, in order to enhance firm performance sustainably. Decisions regarding diversity management in the boardroom are informed by thorough cost-benefit analyses rather than being based solely on ethical considerations (Tajeddini et al., 2023; Sarhan et al., 2018). Incorporating diversity into corporate boards can significantly contribute to improving sustainable financial performance. Boards that exhibit occupational diversity are more likely to achieve better long-term financial outcomes and attract higher levels of investment (Kanakriyah, 2021; Siciliano, 1996). While individual directors may not possess all the necessary skills and knowledge, a diversified board is well-positioned to leverage collective viewpoints through effective communication and collaboration (Belderbos et al., 2022; Kor & Sundaramurthy, 2009). This collaborative approach not only enhances decision-making, but also supports the organization's ability to sustain financial performance over the long term.

However, some researchers have also concluded that exceeding a certain limit of diversity may lead to potential conflicts and delayed decision-making, particularly regarding risk handling, due to differing opinions. Decisions regarding board diversity are not solely influenced by moral considerations, but rather undergo proper cost-benefit analysis to determine the extent and level of diversity (Sarhan et al., 2018). While developed economies have contributed significantly to the literature on diversity management, few studies have examined the impact of board diversity in developing markets (Arif, 2019). Therefore, this study seeks to address existing gaps in the governance literature, particularly concerning the impact of diversity management on sustainable financial performance. Over the past few decades, developing markets have become increasingly integral to the global economy through rapid international trade integration. As a result, research focusing on these markets, particularly on diversity management and its role in enhancing firm performance and driving transformation has been expanding (Ararat et al., 2021; Yasser et al., 2011). So, this study explores how diversity management in corporate boards impacts sustainable financial performance. Diversity management is categorized by gender, nationality, and political affiliation, establishing a framework for diverse board decision-making. This approach is expected to yield several benefits, including enriched experiences, access to a broader range of information, protection of shareholder rights, and the potential for transformative impacts on developing economies. Crucially, these factors collectively contribute to improved sustainable financial performance.

Based on the theoretical background, the main research question is:

RQ: What is the impact of diversity management on sustainable financial performance?

The objectives of the study are as follows:

- to find out the impact of female board members on sustainable financial performance;
- to test the impact of other nationality members on sustainable financial performance;
- to know the impact of the political affiliation of board members on sustainable financial performance.

The structure of this paper is organized to ensure a comprehensive and systematic exploration of the research topic. Section 1 describes the introduction, which outlines the research problem, objectives, and significance. Section 2 presents a thorough literature review, summarizing existing studies and identifying gaps in the current knowledge. Section 3 details the research methodology, explaining the approach, data collection, and analysis techniques employed. Section 4 overviews the research results, and discusses and interprets the findings in relation to the existing literature. Finally, Section 5 concludes the paper by summarizing the key insights and suggesting directions for future research.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Board diversity is widely recognized as a critical element of effective corporate governance, particularly in terms of management and oversight. International regulators and policymakers increasingly view board diversity as a factor that can enhance firm performance and sustainability, thus necessitating empirical examination (Belderbos et al., 2022; Eulerich et al., 2014). Typically, board diversity is integrated through policies and practices designed to foster an inclusive boardroom environment.

The primary goal of emphasizing diversity management is to ensure equal opportunities for all groups such as women and individuals from diverse nationalities to contribute to enhancing firm performance. This approach not only aims to improve immediate organizational outcomes, but also supports sustainable financial performance by fostering diverse perspectives that can drive innovation, effective decision-making, and long-term financial stability (Sessler Bernstein & Bilimoria, 2013). By leveraging diverse viewpoints and experiences, boards can better navigate challenges and capitalize on opportunities, thereby supporting sustained financial success and resilience.

2.1. Gender diversity

When homogeneous teams fail to meet established performance standards, organizations often turn to diversity as a potential solution. A more diverse board is believed to be associated with improved decision-making and more effective monitoring, which can lead to enhanced firm performance and sustainability (Zalata et al., 2022; Kim & Starks, 2016). Darmadi (2013) investigated the impact of gender diversity on financial performance and found that the introduction of females to corporate boards sometimes had a negative effect on firm performance. This reluctance to increase female board representation can be attributed to several factors, such as organizational discomfort with hiring female minorities, and male board members' preference for selecting other males due to personal affiliations or biases. The challenge of finding female candidates with all the requisite traits for board membership and performance improvement. Despite these challenges, there is a growing trend of highly qualified and experienced female professionals, which offers compelling reasons for increasing female representation on corporate boards.

Embracing gender diversity is increasingly recognized as a strategy for sustaining financial performance by leveraging the unique perspectives and expertise that diverse board members bring, ultimately supporting long-term financial stability and growth (Zalata et al., 2022). Currently, women's representation on boards is very low and needs to be increased for better performance results (Singh et al., 2023). Terjesen et al. (2015) reviewed over 180 research publications on the role of gender diversity and concluded that the presence of female board members can positively impact board dynamics. Female board members exhibit a higher percentage of meeting attendance compared to their male counterparts and are found to possess a more balanced and positive attitude in assisting other board members. Moreover, the presence of female board members is justified not solely based on gender, but also on their skills (Tremblay et al., 2016). Their presence creates an environment of attentiveness, enthusiasm, and efficient decision-making, which significantly contributes to better firm performance (Joeks et al., 2013). Christiansen et al. (2016) investigated the relationship between gender diversity in corporate board positions and firm performance.

After analysing two million companies, they concluded that there is a positive relationship between gender diversity and firm performance, even after controlling for other corporate governance factors. Based on the above discussion the first hypothesis of the study is:

H1: There is a positive relationship between the presence of female board members and sustainable financial performance.

2.2. Nationality diversity

When organizations face difficulties in meeting established performance standards, they often look to diversity as a potential remedy. The belief is that a more diverse board can enhance decision-making and improve monitoring, potentially leading to better firm performance and long-term sustainability (Zalata et al., 2022; Kim & Starks, 2016). This perspective aligns with the view that diversity in governance can contribute to more comprehensive and innovative problem-solving approaches, which are crucial for sustained success. However, evidence on the impact of diversity, particularly gender diversity, on firm performance is mixed. Darmadi (2013) found that adding females to corporate boards sometimes negatively affected firm performance. This reluctance to increase female representation can be attributed to several factors, including discomfort with hiring female minorities, male board members' preferences for selecting other males due to personal biases, and the difficulty in finding female candidates who meet all the required qualifications for board membership.

Despite these challenges, the growing pool of highly qualified and experienced female professionals presents a strong case for increasing female representation on corporate boards. Embracing gender diversity is increasingly seen as a strategy to achieve sustainable financial performance. Diverse boards are thought to provide a range of perspectives and expertise, which can lead to more effective decision-making and strategic oversight. This diversity can help organizations better navigate complex and evolving markets, fostering innovation and resilience. Furthermore, diverse boards can enhance a company's reputation and appeal to a broader range of stakeholders, including customers, employees, and investors who value inclusivity and social responsibility. This positive perception can contribute to long-term financial stability and growth. Therefore, while challenges remain, the strategic integration of diverse perspectives, particularly gender diversity, can play a crucial role in driving sustainable financial performance and ensuring that organizations are well-positioned for future success (Zalata et al., 2022).

Darmadi (2011) analyzed the link between firm performance and board diversity using data from Indonesian-listed firms. The research indicated that there is no correlation between nationality diversity and organizational performance. Likewise, Rose (2007) explored the influence of nationality diversity on firm performance, but did not discover any significant relationship. Based on provided arguments the hypothesis of the study is:

H2: There is a negative relationship between nationality diversity and sustainable financial performance.

2.3. Political affiliation diversity

Organizations often prioritize influential board members as crucial assets for fostering strong relationships with the community and competitors, believing that securing the right resources can lead to a competitive advantage and enhance their standing on top-performing lists. The influence of political affiliation diversity on firm performance can be examined from two main perspectives, each with implications for sustainable financial performance. The political affiliation of independent directors can sometimes negatively impact firm performance. Appointments based on political connections rather than merit can result in a governance structure that prioritizes personal networks over organizational benefits (Ahmad Tarmizi & Brahmana, 2022). This misalignment may undermine effective decision-making and long-term performance. For instance, Shahzad et al. (2021) found that political affiliations within executive management negatively affected organizational performance, particularly in larger firms. This suggests that a focus on political connections rather than merit can hinder sustainable financial performance by compromising the effectiveness and objectivity of board oversight. To mitigate this, it is recommended to select board members based on equity financing and merit-based criteria (Junus et al., 2022). This approach helps ensure that board members are chosen for their financial and managerial expertise, which is essential for maintaining long-term organizational stability and growth.

On the other hand, political affiliation diversity among board members can offer substantial benefits. Politically connected directors may facilitate access to subsidies, reduced-rate loans, valuable information, and influential contacts (Ahmad Tarmizi & Brahmana, 2022). Such connections can aid in risk reduction, enhance company operations, improve capital access, and strengthen investor confidence. When board members have strong ties with the ruling government, firms can benefit from better alignment with government policies and economic plans, which can enhance firm performance and sustainability. From a sustainable financial performance perspective, politically affiliated board members can provide critical resources and strategic insights that support long-term planning and resilience. Their knowledge of government initiatives and regulatory changes can help organizations adapt more effectively to external challenges, thereby fostering sustained financial health. However, the benefits of political connections should be balanced with a strong emphasis on merit-based selection to avoid potential governance issues and ensure that political ties are leveraged in ways that align with long-term organizational goals. Based on these perspectives, the third hypothesis could be framed as follows:

H3: There is a positive relationship between political affiliation diversity and sustainable financial performance.

3. RESEARCH METHODOLOGY

To investigate the impact of board diversity management on organizational performance, a combination of dependent and independent variables has been utilized in the study.

The dependent variables of the study are returns on assets (*ROA*) and return on equity (*ROE*) representing the proxy variables of organizational performance. Independent variables of the study are gender diversity (*PFBM*), nationality diversity (*ONBM*), and political affiliation (*PABM*). Finally, the control variables of the study are firm size (*FS*) and leverage (*LEV*). The data for this research analysis was collected from 200 listed firms on the Pakistan Stock Exchange (PSX), covering sectors such as financials, industrials, holding firms, property, services, and mining and oil. The data on the said variables were collected from 200 companies listed on the PSX. A strongly balanced panel data set is developed for analysis purposes with a 10-year time range from 2014 to 2023.

Table 1. The conceptualization and operationalization of the variables

Role in the analysis	*Concept*	*Symbol*	*Variable*	*Description*
Dependent variables	Organizational performance	*ROA*	Return on assets	Net income / Total assets
		ROE	Return on equity	Net income / Shareholders' equity
Independent variables	Board diversity	*PFBM*	Presence of female board members	Presence of female members on the board
		ONBM	Other nationality board members	Different nationality members on board
		PABM	Political affiliation of board members	Board members' affiliation with political parties
Control variables	Firm size	*FS*	Total assets	The logarithm of the total assets of the company
	Leverage	*LEV*	Long-term liabilities / Total assets	Long-term liabilities / Total assets

The equations for the models are presented below. The details of the model specifications are stated in Table 1.

$$ROA = \alpha_0 + \alpha_1 ONBM_{it} + \alpha_2 PFBM_{it} + \alpha_3 PABM_{it} + \alpha_4 LogFS_{it} + \alpha_5 LEV_{it} + \varepsilon_{it} \quad (1)$$

$$ROE = \beta_0 + \beta_1 ONBM_{it} + \beta_2 PFBM_{it} + \beta_3 PABM_{it} + \beta_4 LogFS_{it} + \beta_5 LEV_{it} + \varepsilon_{it} \quad (2)$$

4. RESULTS AND DISCUSSIONS

4.1. Descriptive statistics

Descriptive statistics presented in Table 2 is a very useful tool for getting basic information on central tendency and dispersion of the variables.

Table 2. Descriptive statistic

Variable	*Minimum*	*Maximum*	*Mean*	*Std. dev.*
ROE	-62.38	93.09	13.87	14.19
ROA	-25.77	66	6.07	7.06
PFBM	0	1	0.39	0.48
ONBM	0	1	0.29	0.45
PABM	0	1	0.64	0.47
LogFS	1.31	5.60	3.92	0.79
LEV	0.1	0.87	0.27	0.14

4.2. Correlation matrix

The most widely used technique for measuring correlation is Pearson correlation. The coefficients of Pearson correlation are meant for measuring the magnitude of the relationship between two continuous variables and it is believed to be the best one due to the utilization of the covariance method. Here in Table 3, most independent variables have a significant correlation with dependent variables.

Table 3. The matrix of correlation values

Variable	*ROA*	*ROE*	*PFBM*	*ONBM*	*PABM*	*LogFS*	*LEV*
ROE	1.00						
ROA	0.73*	1.00					
PFBM	0.10*	0.02	1.00				
ONBM	-0.04	0.02	-0.10*	1.00			
PABM	0.11	0.21*	-0.02	0.03	1.00		
LogFS	-0.005	0.19*	-0.18*	-0.32*	0.12*	1.00	
LEV	-0.30*	-0.38*	0.03	-0.06*	-0.10*	-0.29*	1.00

*Note: * and ** represent statistical significance at the 5% and 1% p-levels, respectively.*

Table 4. Hausman test

Chi²	*Prob. > Chi²*
Model 1	
22.29	0.00
Model 2	
37.24	0.00

Table 5. Heteroscedasticity test

Source	*Chi²*	*Df*	*Prob.*
Model 1			
Heteroscedasticity	147.75	17	0.00
Model 2			
Heteroscedasticity	129.23	17	0.00

Table 6. Variance inflation factor (VIF) and fixed effect model with robust standard error: Models 1 and 2 (Part 1)

Variable	*VIF*	*Coefficient*	*Robust std. error*	*t*	*P > t*
Model 1, dependent variable — ROA					
PFBM	**1.04**	**1.8465**	**0.8436**	**2.19**	**0.03**
ONBM	1.13	-0.0930	0.7031	-0.13	0.89
PABM	**1.04**	**0.7890**	**0.7890**	**5.73**	**0.00**
LogFS	1.24	0.6658	0.6658	1.91	0.23
LEV	1.08	**2.3819**	**2.3819**	**-2.68**	**0.00**
		F = 17.58		Prob. > F = 0.00	

Table 6. Variance inflation factor (VIF) and fixed effect model with robust standard error: Models 1 and 2 (Part 2)

Variable	*VIF*	*Coefficient*	*Robust std. error*	*t*	*P > t*
		Model 2, dependent variable — ROE			
PFBM	**1.04**	**3.7483**	**1.2781**	**2.93**	**0.00**
ONBM	**1.13**	**-3.3250**	**1.4864**	**-2.24**	**0.02**
PABM	**1.04**	**1.3060**	**1.9866**	**6.57**	**0.00**
LogFS	1.24	1.5108	1.6366	0.92	0.35
LEV	**1.08**	**-3.2708**	**1.6068**	**-5.93**	**0.00**
		F = 17.58		Prob. > F = 0.00	

4.3. Discussion of the results

The Hausman test aids in determining whether a fixed effect model or a random effect model is more suitable for panel data analysis (Asteriou & Hall, 2011). A small difference value with a significant probability indicates a preference for the fixed effect model, whereas a small difference value with an insignificant probability suggests the random effect model. In our case, the estimation of the Hausman test favors the fixed effect model due to a comparatively small difference value alongside a significant probability value. This choice is reinforced by the presence of heteroscedasticity in the data, as noted in Tables 4–6, leading us to apply the fixed effect model with robust standards to both models.

Regarding the relationship between the presence of female board members in executive management and firm performance, findings align with Zalata et al. (2022), who observed a positive correlation and increasing trend in the performance contribution of female board members compared to males. Female board members tend to possess better qualifications and greater experience, providing compelling reasons for hiring authorities to increase female representation. On the other hand, the probability value for nationality diversity in both models indicates an insignificant or negative relationship with firm performance. This finding resonates with Prencipe et al. (2023), who highlight the challenges faced by top management in dealing with directors from different nationalities due to differences in communication patterns and cultural perceptions.

Board members with political affiliations positively influence organizational performance. Many organizations prioritize having influential board members as vital resources for engaging with the community and competitors. By acquiring these resources, firms can gain a competitive advantage, often leading them to be ranked among the top performers which is also consistent with the findings of (Ahmad Tarmizi & Brahmana, 2022). Leverage and company size were included as control variables in the model. The study found a significant negative relationship between leverage and firm performance, while the relationship between company size and firm performance was found to be insignificant.

5. CONCLUSION

Diverse board members can enhance firm performance by fostering comprehensive discussions that lead to more cautious and calculated risk-taking. The primary objective of promoting diversity on corporate boards is to ensure that all groups have equal opportunities to contribute, thereby improving overall firm performance. Gender diversity is increasingly recognized for its positive impact on decision-making and risk management, which supports long-term stability and growth. Female directors are often praised for their balanced and constructive approach, which can positively influence board dynamics and decision-making. Conversely, nationality diversity, while valuable for bringing different perspectives, may present challenges such as communication barriers that can hinder board effectiveness. Therefore, organizations should implement strategies to overcome these barriers and leverage the benefits of international perspectives while ensuring efficient and cohesive board operations.

Political affiliations also play a significant role in shaping firm performance. Board members with strong political ties to the ruling government can offer substantial advantages, such as access to subsidies, reduced-rate loans, valuable information, and relevant contacts. These benefits can enhance the firm's strategic positioning and overall performance, especially when aligned with government policies and economic plans.

However, while potentially beneficial in the short term, there should be a balance with merit-based selection criteria to ensure that board decisions are made based on expertise and strategic alignment rather than political connections alone. This balance is crucial for sustaining long-term financial performance, as it helps mitigate the risks associated with over-reliance on political ties and ensures that board decisions are grounded in organizational objectives and market realities.

Future research should address the mentioned limitations to provide a more comprehensive understanding of board diversity and its impact on firm performance. Current analyses primarily rely on secondary data. Future studies should include primary data collection to gain deeper insights into how diversity impacts board dynamics and firm performance. To enhance understanding, future research should incorporate variables related to ethnic and cognitive diversity. This would provide a fuller picture of how various forms of diversity interact and contribute to board effectiveness and sustainable financial performance. By addressing these areas, future research can offer more nuanced insights into the dynamics of board diversity and its implications for long-term organizational success.

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