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PERADENIYA INTERNATIONAL ECONOMICS RESEARCH SYMPOSIUM - 2019

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Volume VII

17TH AND 18TH OCTOBER 2019

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The Impact of the Proportion of Female Directors on Firm Performance: An Approach to Achieve Gender Equality

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Keywords: *Colombo Stock Exchange; Financial Performance; Gender Equality; Women Directors*

Introduction

Sri Lanka is well known as a country that ended a 30-year civil war of which the scars have not yet healed. The end of this brutal civil war was also a beginning of a new era of peace and development. Sri Lanka can only achieve sustainable development via long-term investments in economic, human and environmental capital. The inclusion of a focus on gender equality as the 5th goal within the Sustainable Development Goals (SDGs) illustrates the importance of women's contribution to the economic growth. Both empowering women and ending gender based disparities are essential for sustainable development. More vigorous efforts will be required in order to achieve gender equality in terms of women's empowerment even though it is evident that there are changes in the stereotypes that prevailed in the past. If a country makes better utilization of its female population, it would pave the way to increase economic growth, reduce poverty levels and enhance the well-being and living standards of its citizens. In order to close the gender related gaps, the governments have the responsibility to take into account the gender dimensions while implementing policies so that it can ensure that it doesn't fail to make complete utilization of human capital resources (OECD, 2008).

The focus and concern for women representation in business management has increased specially after the financial crises and corporate scandals such as Lehman Brothers and Enron. Many countries in Europe have adopted regulations in the form of legislative gender quotas for corporate boards. The main aim of implementing such gender quotas is to break the glass ceiling and provide an equal chance for both males and females in reaching top positions of companies. However, the underpresentation of women in senior positions in Sri Lankan firms indicates that they do not play a dominant role in the labour force as do females in developed economies. This is mainly due to women in developing economies such as Sri Lanka being typically confined to family and domestic roles and therefore tending to have invisible barriers in climbing up the corporate ladder and representing themselves on boards. Therefore, the Labour Force Participation Rate (LFPR) is low in Sri Lanka mainly due to the low contribution of women to the LFPR (CBSL, 2014).

The issue of underrepresentation of women in corporate boards has gained substantial attention in today's corporate world. There is a significant amount of evidence supporting this research issue in the developed countries. "In an attempt to address this question, many scholars in the recent years have studied the effect of women directors on firm performance. However, the empirical evidence of the extant literature inconclusive and most studies focus on firms in the U.S. and a few other developed economies" (Liu, Wei and Xie, 2014, p.170). Thus, investigating this research gap in a Sri Lankan context will be important to identify the extent to which women directors in the listed firms of Sri Lanka have the power to make strategic decisions and enhance firm financial performance. The role of public listed companies is important since they have the ability to boost the performance of an economy by contributing to the growth of financial institutions, creating employment opportunities and developing infrastructure facilities. If board gender diversity can trigger profitability and performance of the listed firms, then it will also be a determinant for economic growth.

Objective

The main purpose of this study is to investigate the impact of the proportion of female directors on firm performance of companies listed in the Colombo Stock Exchange (CSE).

Methodology

In order to investigate the impact of the proportion of female directors on firm financial performance, this study is based on a panel data set of the 297 CSE-listed companies. There are two main panel estimation methods commonly used in literature which are pooled Ordinary Least Squares (OLS) and panel regression with Fixed Effects (FE). However this study employed panel regression FE to estimate the main regression model as this method helps to avoid constant omitted variable bias and yearly FE due to unobservable heterogeneity. This study overcomes limitations of the existing Sri Lankan literature by selecting all the listed firms in all the CSE classified sectors during the period of 2012 to 2018. Consisting of unobservable and unavailable data, the final data set consists of 1,865 firm-year observations on over 281 listed companies. The following is the main regression model in this study:

$$FFP_{it} \ = \ \gamma \ BGD_{it} + \beta_1 BC_{it} + \beta_2 FC_{it} + \alpha_i + \pi_t + \varepsilon_{it}$$

with FFP: Firm Financial Performance (Return on Assets ratio), BGD: Board Gender Diversity (Propotion of women directors on board), BC: Board Char (Board characteristics), FC: Firm Char (Firm characteristics), *i*: Company and *t* : Time, α: intercept, π : Individual impact with the time and ε: white noise error term.

Variables of the regression model were chosen based on the common variables used to measure the impact of women directors on firm performance in the literature. *Financial Performance* measures the extent to which companies achieve their financial goals and this is essential to determine the success of the firms. In this study, Return on Assets (ROA) ratio is used as the proxy to measure financial performance since ROA is a widely used financial performance indicator (Liu, Wei and Xie, 2014). This ratio can be calculated as net income divided by total assets. The proportion of women directors on the board is taken as proxy to measure the BGD. This was measured using the percentage of female directors on the board. Control variables used in this model are grouped into two categories, BC and FC. The board characteristics consist of chairwoman, independent board directors, board size and Chief Executive Officer (CEO) duality while the firm characteristics consist of leverage and firm age. With regards to the control variables, chairwoman is a dummy variable that equals 1 when the board chair is a woman and 0 otherwise. Independent directors is the percentage of independent directors in the board. Boardsize is the natural log of the board size. CEO duality is a variable that equals 1 when the chairperson and CEO is the same person and

0 otherwise. Leverage is the total debt divided by total assets. Firm age is the natural log of the number of years that the firm is listed with CSE.

Results and Discussion

Table 1 shows the descriptive statistics for all the variables used in this study for 1865 firm–year observations. The approximation of ROA has a mean value of 5.2%. The mean percentage of women in the director board is 0.08 which is remarkably low. The average board size is equal to 8.02 and the maximum number of directors in the board is 18 while the minimum is 2. Average independent directors of the director board, is reported as 38.8%. The average leverage ratio reveals that the CSE listed companies have a mean of 45.6% of debts relative to their assets.

Table 1: Summary statistics of panel regression model

Variable	Obs.	Mean	Std	Min	Max
Performance measures					
ROA (net income/assets)	1865	5.2	0.15	-2.18	2.52
Board gender characteristics					
% of women directors	1865	8.4	0.11	0	0.75
Control variables					
Board characteristics					
Chairwoman	1865	4.0	0.19	0	1
% of independent directors	1864	38.8	0.14	0	2.08
Board size	1865	2.04	0.30	0.69	4.50
CEO duality	1865	13.2	0.33	0	1
Firm characteristics					
Leverage	1865	45.6	0.40	0	6.68
Firm age	1795	2.78	1.02	-0.69	4.28

This study employs FE method to estimate the effects of board gender diversity on firm financial performance. Table 2 shows the findings of the main regression model.

Table 2: Results of Regression Model

	ROA (net income/assets)	
	FE	SE
%_Women	0.1332*	0.0757
Woman_Chair	-0.0377	0.0397
%_Independent	-0.0041	0.0407
Ln_Boardsize	-0.0269	0.0189
Duality	0.0421	0.0318
Leverage	-0.0236*	0.0148
Ln_FirmAge	-0.0236**	0.0103
Constant	0.1713***	0.0524
R^2 within	0.0110	
between	0.004	
overall	0.001	
F. Sig	0.0144	
rho	0.6007	

Note: *** Significant at 1% level; ** Significant at 5% level; * Significant at 10% level.
SE: Standard error of each coefficient.

The results suggest that women directors have a positive and statistically significant impact on firm financial performance. For instance, with a 1% rise in percentage of women directors, ROA increases by 0.13%. With regards to other control variables, results in Table 2 reveals that leverage and firm age have a significantly negative impact on ROA while the other control variables do not have any statistically significant impact. Therefore, the positive impact created by women directors on the financial performance of the firms implies that gender diverisity can be beneficial for firm performance. In addition, the presence of women directors on the board can attract more female employment and lead to an increase in the female LFPR and eventually contribute to the potential output of the economy. Female directors have the ability to create a positive impact on the financial performance of the firms since their presence in the board may reduce the agency conflict or the cost as they are more responsible of their duties and tend to freely express their opinions while having a concern for the shareholders' wealth (Pasaribu, 2017). Proper gender diverse boards improve monitoring and controlling functions by increasing the effectiveness of decision making. The reason is that the women directors tend more towards questioning while men are stumble to ask questions (Wellalage and Locke, 2013). A balanced board always provides more opportunities of achieving competitive advantages over market challenges than boards which are completely dominated by male directors (Liu, Wei and Xie, 2014).

Conclusion

The empirical findings of the research reveal that women directors have a positive and statistically significant impact on firm financial performance. It also reveals that leverage and firm age have a significantly negative impact on firm financial performance. In developing economies such as Sri Lanka the effectiveness of corporate boards resulting from gender diversity is still a new area of research. In order for the Sri Lankan economy to grow at a reasonably high pace and to meet the changing demands of the various sectors, there should be well diversified labour force and corporate boards. By tracking the presence of female directors in this study, the extent to which boards are dominated by men, and whether women have attained an equal opportunity to dominate with power in the corporate environment of Sri Lanka, will be evident. Unlike the firms in many developed economies, Sri Lankan listed firms have no compulsory gender quotas to comply with when determining its board gender composition. The findings of this study will be important for the practitioners as it provides a contribution in support of female composition in corporate boards. It will also be useful for policy makers such as United Nations (UN) since such organizations are interested in ensuring the rights of women and in implementing gender inclusive policies. Moreover, the results obtained will support institutions such as the International Finance Corporation (IFC) of the The World Bank to increase the representation of women directors in the corporate boards of the firms in Sri Lanka. This study encourages women participation in senior positions and corporate boards thereby reducing the gender based discrimination in such positions since it is evident from these results, that women directors also have the ability to drive the financial performance and increase the profitability of various sectors in Sri Lanka and they equally deserve the right to be a part of every company's corporate board. Therefore, it is important to strategically focus on gender diversity in the process of policy making and gender equality related sustainable development.

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