

# Board Gender Diversity and Financial Performance in Developing Countries: Evidence from the Ethiopian Banking Sector

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## ABSTRACT

The topic of board gender diversity has drawn the attention of academics, organizations, and regulators alike. Such heightened awareness of the subject has produced a favorable atmosphere for gradual growth in women's participation in boardrooms worldwide. Countries have even taken the initiative to legalize boardroom quotas to increase the proportion of females in the boardroom of organizations. The current study investigated the effect of women's boardroom representation on the financial well-being of banks. The study considered fourteen commercial banks in Ethiopia as a sample. The study period ran from 2013 to 2020. The study employed OLS and fixed effect regression for analysis and found out that the representation of women in the boardroom of banks pays off. The result is robust for alternative measures of financial performance. The outcome of the study has far-reaching implications for policymakers and managers of financial institutions. Ethiopia's financial regulators should push for legislated boardroom quotas to enhance the representation of women in the boards of banks. Additionally, banks should make the appointment of additional female board members a priority. The study also contributes new insights to the body of knowledge already available on the subject.

**Keywords:** gender diversity; boards; women board room representations; financial performance

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## INTRODUCTION

Board gender diversity has been a topical issue for academic researchers, organizational managers, regulatory agencies and international NGOs [1, 2]. And firms worldwide are facing growing pressure to rectify the gender gap in top positions [3]. As a result, some nations, including Norway, France, and Italy in Europe, as well as Kenya and South Africa in Africa, have taken steps to adopt "legislated boardroom quotas", which require companies to maintain a specific gender balance in their boardrooms.<sup>1</sup> Part of the rationale for board gender diversity's significance is that many stakeholders recognize that it is just as crucial for meaningful boardroom discussions as it is for profitability.<sup>2</sup>

<sup>1</sup> a) African Development Bank. Where are the women: inclusive boardrooms in Africa's top listed companies? 2015; b) ILO. Women on Boards: Building the female talent pipeline. International Labour Organization. 2016. URL: [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31480/11-745-women-on-boards.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/31480/11-745-women-on-boards.pdf) (accessed on 01.02.2023).

<sup>2</sup> Deloitte. Women in the boardroom: A global perspective (Fifth Edition). Deloitte Global Center. 2017. URL: <https://www2.deloitte.com/content/dam/Deloitte/my/Documents/risk/my-risk-sdg5-women-in-the-boardroom-a-global-perspective.pdf> (accessed on 03.01.2023).

Organizations with a gender diverse boardroom are associated with superior corporate governance, a high level of societal engagement, and quality products[4]. In addition, there is now ample evidence that women's representation in corporate board rooms is: an enabling factor for good governance [5, 6]; reduces the possibility of exposure to "bankruptcy risk" [7] enhances the overall efficiency of firms and expedites the strategic change process [8]; leads to enhanced financial management practice [9]; and contributes to a decline in the variation of returns [10].

Most board gender diversity studies focus on organizations in developed countries. However, there is an apparent difference in the level of government intervention, ownership structure, the efficiency of financial markets and legal framework, and most importantly, the level of women's representation in the workforce between developed and developing countries (11).

[risk-sdg5-women-in-the-boardroom-a-global-perspective.pdf](https://www2.deloitte.com/content/dam/Deloitte/my/Documents/risk/my-risk-sdg5-women-in-the-boardroom-a-global-perspective.pdf) (accessed on 03.01.2023).

The relationship between financial performance and gender diversity depends on institutional and country-specific contexts [12]. In countries with a favorable attitude towards women at work, the effect of board gender diversity on financial performance is magnified [13]. Such differences might affect the nature of the relationship between board gender diversity and financial performance. Added to this, most gender-related studies in developing countries mainly focus on social, psychological and economic issues. As a result, matters like gender-based violence, participation of women in household decision making, economic empowerment of women etc. have gained wider popularity among researchers.

Previous research on gender diversity also focused mainly on the non-financial sector, and the results seem to be inconclusive. The banking sector, due to its opacity and high regulation, differs from firms in other sectors [11]. This implies that more research is required to address the issue in the context of the banking sector.

The study contributes to the existing literature by unraveling the relationship between gender diversity and financial performance in developing countries. The study also contributes to knowledge in the area by investigating the issue in the context of the banking sector, where there is a relative paucity of research.

This study focuses on investigating the issue in the context of the Ethiopian banking sector. Studies conducted by [14] & [15] indicate the presence of the underrepresentation of women in managerial positions of various organizations in Ethiopia.

The rest of the article proceeds as follows: The theoretical underpinnings and the study's hypotheses are presented in the next section. After that, the methods used are described. The findings are then presented and discussed. The final segment concludes the research.

## THEORY AND HYPOTHESIS DEVELOPMENT

### Theoretical Framework

The theoretical groundwork supporting the link between board gender diversity and organizational performance is extensive. Agency theory is one of the most often used in this area. Separation of ownership and management characterizes corporations. And

as a result, it is difficult to expect that the agents (managers) will fully commit themselves to serving the owners' interests. Such divergence of interest between agents and principals is the primary source of agency problems [16], which opens room for management to engage in "self-serving behavior" [17]. Corporate governance arrangements relating to the board, like board gender diversity, can be utilized to reduce the occurrence of the agency problem and align managers' interests with those of the owners [1, 18].

Gender diversity on boards creates an enabling environment for effectively supervising and controlling managers [19]. The enhancement of board supervision and control due to gender diversity comes from "(a) expanding the perspectives around the table, (b) increasing board independence, (c) eroding the male groupthink phenomenon, and (d) improving the attendance behavior of the board" [20, p. 4]. Women are more likely to ask tough questions, challenge the existing norm, and see fresh possibilities. In addition, hiring women from various racial, age, and national backgrounds can instantly extend the monitoring process's purview [21, 22]. Women directors also have unique leadership qualities and a high level of commitment (2) and, as a result, are critical players in the "operational" and "strategic" control process [23]. This translates into better performance [24].

The other prominent theory used to justify board gender diversity in organizations is the resource dependency theory. According to RDT, organizations are part of a broader system and depend heavily on the resources of the external environment for their continued survival. The theory has it that "organizations that cope better with uncertainty and can reduce uncertainty for their stakeholders and which have control over scarce resources and the substitutability of their controlled resources, have a competitive advantage" [25, p. 427]. The resource dependency hypothesis acknowledges the significance of external influences on organizational behavior. Despite their limits, boards of directors and management can take actions to reduce risk and dependency [26].

The board of directors provides four benefits to businesses: "(a) information in the form of guidance and counselling, (b) access to information channels between the firm and environmental contingencies,

(c) preferential access to resources, and (d) legitimacy” [27, p. 145].

Considerable empirical evidence supports these anticipated advantages. A diversified boardroom, where more women are represented, can link organizations to the external environment [28]. According to the resource-based view, board gender diversity is a valuable mechanism that can boost a company’s productivity, creative ability, and critical decisions by expanding the range of accessible skills, viewpoints, knowledge, and social networks [29].

The other perspective used as an alternative in the debate is based on critical mass theory. The proponents of the theory [30] argue that mere representation of women in the boardroom may not bring meaningful change. The author indicates that as long as women are not represented in a particular proportion, they remain considered “tokens” with no significant contribution to boardroom decision-making [30, 31]. They propose three women inside a boardroom for the magic of “critical mass” to work. Three women in the boardroom can change the dynamics of the board and can equally participate in the decision-making process [32]. This happens because “first, multiple women help break the stereotypes that solo women are subjected to. Second, a critical mass of women helps to change an all-male communication dynamic. Third and finally, research on influence and conformity in groups indicates that three may be somewhat of a “magic number” in group dynamics, which suggests that having three women may be particularly beneficial for creating change” [33].

### Hypothesis Development

#### ***Board Gender Diversity and Financial Performance***

Companies with a diverse board of directors perform well because they anticipate market demands, have a highly “creative and innovative” workforce, and project a favorable image [34]. Board diversity can take different forms. The presence of skilled and experienced women in the boardroom is one way to demonstrate it. Women may follow a unique decision making procedure that boosts financial performance [35]. They may also be better at identifying, perceiving and controlling risk [36]. And this leads to better decision making and improved performance. The presence of more women in the boardroom may also contribute to more transparency and

accountability, leading to enhanced decision-making quality [37]. More to this, [38] argue that women better understand the needs of customers and other stakeholders. These factors enable women to be more effective in dealing with business difficulties, particularly finance and personnel [39].

The evidence linking gender diversity and financial performance is equivocal. A systematic literature review of more than ninety articles from greater than sixty journals made by [40] proved that the finding regarding the two variables is inconclusive.

A study undertaken by [41] aimed to relate board diversity with the performance of a sample panel of French-listed firms during the 2009–2011 period. The researchers discovered that gender diversity on boards has a deleterious influence on financial performance [39]. In a study conducted by considering a large sample over eight years, they also indicated that gender diversity has a significant negative relationship with performance.

An investigation on the effect of board gender diversity on financial performance was made by [42] on a sample of 112 big US public firms. The firms belonged to various categories like financial services, manufacturing, and other industries. Two measures of board diversity were used, ethnic diversity and gender diversity. Financial performance was measured using ROA and ROI. Results of the study reveal that board diversity positively and significantly affects firm performance. A similar type of finding was reported by [43] after studying the effect of corporate governance structure (measured using board size, board composition, internal board committee, and board gender diversity) with the financial performance of banks. The sample consisted of selected commercial banks in Zimbabwe.

The effect of board gender diversity on the performance of banks was also investigated by [44]. The study was undertaken to assess the effect of gender diversity on financial performance and risk and extend the literature by providing evidence of the issue from developing countries. The data for the study was obtained from 10 listed Tunisian banks for the period 2005–2018. The author found a significant and positive relationship between gender diversity and financial performance (measured using ROA and ROE). A similar finding is reported by [45], who conducted a study to investigate the relationship between board gender diversity and

firm performance using five-year data of the listed entities on the stock market. Results indicate that gender diversity measured at three levels (a dummy variable, proportion of female directors on board, and an index) is significantly and positively related to performance.

A study by [46] investigated the impact of board diversity on the performance of Kenyan commercial banks. In contrast to the conclusions of the previous authors, the results of their analysis show that gender diversity (as assessed by female presence in the boardroom and the proportion of female to total board members) had no meaningful impact on bank financial performance.

The findings of some authors indicate that, although there exists a favorable link between the two variables, the attitude that people have towards working women tends to moderate the relationship. For example, [13] empirically investigated the effect of board gender diversity on the financial performance of a sample of Asian firms from Hong Kong, South Korea, Malaysia, and Singapore. The finding of the study indicates that board gender diversity has a positive and significant impact on performance. The study results further suggest that the relationship between board diversity and performance tends to be stronger in countries where women can participate in leadership roles. They also discovered that the relationship tends to deteriorate in nations where women's participation in labor is discouraged.

Other studies report a non-linear relationship and argue that without a "critical mass", female boardroom representation is only symbolic. For instance, [20] studied the relationship between board gender diversity and financial performance in Fortune 500 firms using seven years of panel data. The result indicated that there exists a non-linear link between the two. Further, and most importantly, the authors found out that women's size should be at least 30% for a meaningful effect on performance.

The current study bases its claim on agency and resource dependency theory and puts forth the following hypothesis:

**H<sub>a</sub>:** The presence of women in board room has a favorable effect on the financial performance<sup>3</sup> of banks.

<sup>3</sup> There are various proxy indicators of financial performance. The current study, following the footsteps of previous researcher, measures financial performance using return on equity (ROE).

## DATA AND VARIABLES

The study included fourteen commercial banks that are operating in Ethiopia. The emergence of modern banking in Ethiopia dates back to 1905, when the first bank, Bank of Abyssinia was established. Currently, there are more than 18 banks operating throughout the country. The banks that were selected as a sample for the study are mostly established from the year 1994 onwards. Thirteen of the sample banks are privately owned local banks. The fourteenth bank included in the study is a publicly owned bank whose establishment goes back to the year 1963. In terms of size, although the private banks are showing a remarkable growth, the publicly owned bank is the dominant one. The banks included in the study were purposefully selected based on the fulfilment of relevant criteria. To be included in the study, first, the banks should be in operation in all the study periods (2013–2020). Secondly, they should report female boardroom representation, the board size, and financial performance-related data. Data for the study was solicited from the annual reports of the banks. Previous researchers used a similar approach (see, for example, [18]).

### Measurement of Variables and Econometric Specification

There were three groupings of variables in the study: dependent, independent, and control factors. The study's independent variable is financial performance, as defined by the degree of return on equity. Financial performance was measured using accounting-based figures. Previous researchers have also used a similar procedure (see, for example [4, 47, 48]). Market-based data was not used as there is no active stock market in the country.

The board's gender diversity is the dependent variable. It is measured as a dummy variable with a value of "1" indicating the presence of women in the boardroom and "0" indicating their absence. The same approach was followed by [49, 50].

In addition, the study considers board size, business size, leverage, bank age, and deposit size. Previous researchers used similar control variables, see, for example [28, 52, 53]. The detailed description and measurement of the variables are presented in the *Table 1*.



Table 1

## Variable Description

Variable abbreviation	Measurement	Supporting literature
<b>Dependent variable</b>		
ROE	<b>Return on equity (ROE)</b> refers to the profit generated by a bank's shareholders for each dollar invested in the bank's stock. The net income to average equity ratio is used to calculate it	[4, 47, 48]
<b>Independent variable.</b>		
FDR	<b>Female director board room representation:</b> relates to the representation of women in boardrooms. It is measured as a dummy variable with a value of "1" indicating the presence of women in the boardroom and "0" indicating their absence	[49–51]
<b>Control factors</b>		
BZ	<b>Board size:</b> refers to the total number of board members in a given year. The logarithmically converted value of the counted size of boardroom members is used to calculate it	[28, 52, 53]
SZ	<b>Firm size:</b> refers to the size of the banks as measured by the logarithmically transformed value of the total asset of each bank	
LVER	Refers to the level of debt in the capital structure of the banks. It is measured by scaling total debt to the total asset of the banks	
Ag	<b>Age:</b> refers to the number of years that have elapsed from the official establishment of each bank. The age of each bank is logarithmically transformed value	
DEP	<b>Size of deposit:</b> refers to the size of operation (in terms of level of deposit) for each bank. It is simply the logarithmically transformed value of total deposit in the balance sheet of each bank	

Source: Compiled by the author.

The regression model used in the study is specified as follows:

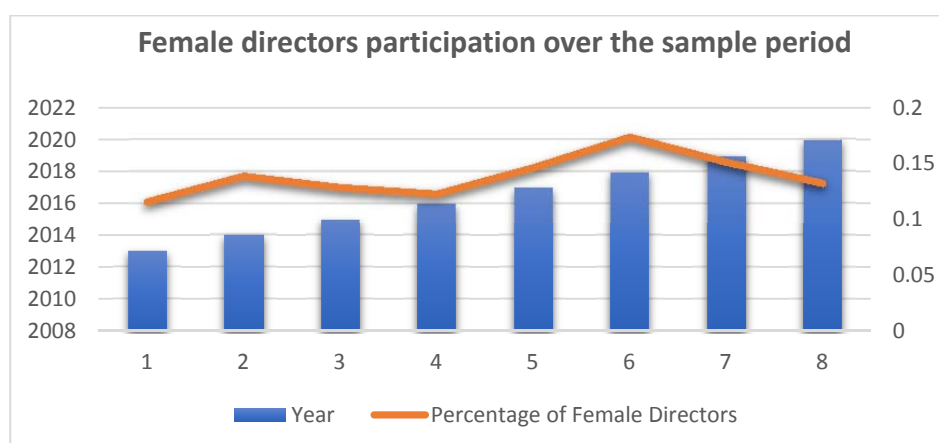
$$ROE_{it} = \beta_1 FDR_{it} + \beta_2 \lg BZ_{it} + \beta_3 \lg SZ_{it} + \beta_4 Lver_{it} + \beta_5 \lg AG_{it} + \beta_6 \lg DEP_{it} + \varepsilon_{it},$$

where  $ROE$  — refers to the return on owners' equity for bank  $i$  at time  $t$ ;  $FDR$  — refers to the representation of female director in the boardroom of for bank  $i$  at time  $t$ ;  $\lg BZ$  — refers to the logarithmic transformed value of the board size of bank  $i$  at

time  $t$ ;  $\lg SZ$  — refers to the logarithmic transformed value of the total asset of bank  $i$  at time  $t$ ;  $Lver$ , refers to the leverage of bank  $i$  at time  $t$ ;  $\lg AG$  — refers to the logarithmic transformed value of the age of bank  $i$  at time  $t$ ;  $\lg DEP$  — refers to the logarithmic transformed value of the total deposit of bank  $i$  at time  $t$ .

## RESULTS AND DISCUSSIONS

The following section presents the result obtained from the analysis and discusses its implications. As shown in Table 2 below, the average value of



**Fig. Percentage of Female Directors over the Years**

Source: Authors computation.

**Table 2**

### Descriptive Statistics

	Mean	Median	Maximum	Minimum	Std. Dev.
ROAE	0.154528	0.138187	0.494012	0.019351	0.072246
FDR	0.776786	1	1	0	0.418272
LGBS	2.315212	2.302585	2.639057	1.94591	0.162246
LGTASS	23.56272	23.51082	27.42503	20.63572	1.29294
LEV_	0.862064	0.867445	0.958134	0.740482	0.041372
LGAG	2.585453	2.639057	4.343805	0.693147	0.729962
LGDE	1.880789	1.878556	3.130523	1.048475	0.378502

Source: Authors computation.

the return generated on equity investment of the banks' shareholders is 15.4%, and there is a small deviation among the selected banks. In terms of female boardroom representation, more than 77% of the banks included in the sample have at least one female member on their boards. However, this value shows a more significant deviation among the banks. The logarithmic values of the board size, age and deposit of the banks have a mean value of 2.3, 2.58 and 1.88. The deviations for age and deposit level are somewhat higher among the selected banks. The average level of debt to the asset (referred to as leverage) is found to be 86%.

Female directors' engagement in the banking sector has increased from 11% to 17% over the sample period, as shown in Fig. This is mainly due to a shift in attitudes toward women in positions of leadership. It also means

that the number of qualified and competent women on the job market is growing.

The result summarized in Table 3 relates to the regression output for the OLS and fixed-effect models. Before running the regression, the researcher first made sure that the model fulfilled all the assumptions of OLS. Then, the four requirements (normality, multicollinearity, autocorrelation and heteroskedasticity) were checked using various statistical procedures. First, normality was checked using the Jarque-Berra procedure.

The output from both the OLS ( $\beta = 0.0783793$  &  $p < .05$ ) and fixed effect regression ( $\beta = 0.017632$  &  $p < .01$ ) revealed that female boardroom representation (FDR) has a significant and favorable effect on the financial performance. The result implies that our hypothesis can be accepted. It also indicates that female board members,

Table 3

## OLS and Fixed Effect Regression Output

Dependent Variable ROE		
Variable	OLS	Fixed Effect
C	-.344201	<b>2.742102***</b>
	(.3842722)	(0.599141)
FDR	<b>.0783793**</b>	<b>0.017632**</b>
	(.0258851)	(0.007295)
LGBS	<b>-.0997376*</b>	<b>-0.076204**</b>
	(0.0552961)	(0.034961)
LGTASS	<b>-.0646139***</b>	<b>-0.029296***</b>
	(.0244387)	(0.007094)
LEV_	.9822398	-3.289473
	(.568385)	(0.877746)
LGAG	<b>.0986853***</b>	<b>0.067074***</b>
	(.0317585)	(0.016918)
LGDE	<b>.1599713*</b>	0.493292
	(.0687203)	(0.112203)
Adjusted R-squared	0.5089	0.554278
F-statistic	4.61	8.264948
Prob (F-statistic)	0.000000	0.000000
Durbin-Watson stat	1.699501	1.606075

Source: Authors computation.

Notes: In the above Table FDR represents inclusion of female board members in the board room; LGBS refers to the logarithmic transformed value of board size; LGTASS pertains to the logarithmic transformed value the total asset of the banks; LEV\_ relates to the leverage of the banks; LGAG refers to logarithmic transformed value the total age of the banks counted from the year of establishment; LGDE represents logarithmic transformed value the total deposit of the sampled banks. Robust value of standard errors is reported in the parenthesis.

although their representation is lower, are dedicated enough to properly supervise and control managers for the benefit of the shareholders. It can also mean that women in the boardroom might have used their knowledge, expertise, and external connections to secure competitive advantages for their banks. The result of the study conforms with the findings reported by [54, 55].

The findings of the study also conform with the result reported by [48]. Women, according to these researchers, appear to supplement the inadequate institutional and corporate governance systems in developing nations.

The result conforms to the assertion of agency theory, which claims that women board members are better at aligning managers' interests with shareholders' value. The result also discovered evidence to support resource dependency theory, which claims that women are better at leveraging their external relationships and networks to improve their organization's success.

In terms of control variables, it was found that board size has an inverse and significant impact on performance. This indicates that the potential benefits of increasing board members' size might be outweighed by its harmful repercussions. An increase in size is

Table 4  
Fixed Effect Regression Output

Dependent Variable NIM	
Variable	Coefficient
C	–0.088905 (0.057191)
FDR	<b>0.004656***</b> (0.001424)
LGBS	–0.007454 (0.005394)
LGTASS	0.016413*** (0.001693)
LEV_	–0.306649*** (0.070919)
LGAG	–0.008513** (0.002943)
LGDE	0.026499** (0.009736)
Adjusted R-squared	0.819694
F-statistic	27.55901
Prob (F-statistic)	0.000000
Durbin-Watson stat	1.711589

Source: Authors computation.

Notes: In the above table FDR represents inclusion of female board members in the board room; LGBS refers to the logarithmic transformed value of board size; LGTASS pertains to the logarithmic transformed value the total asset of the banks; LEV\_ relates to the leverage of the banks; LGAG refers to logarithmic transformed value the total age of the banks counted from the year of establishment; LGDE represents logarithmic transformed value the total deposit of the sampled banks. Robust value of standard errors is reported in the parenthesis.

mainly related to possible disagreement among large members who can't come to terms and the accompanying protracted decision-making procedure. The size of banks had an inverse and significant relationship with performance. And it was also found that an increase in the age of banks is associated with better performance.

#### Robustness Test

The robustness of the result was tested by employing an alternative measure of financial performance (see Table 4). The variable net interest margin (the difference between interest revenue and expenses scaled by average interest-earning asset) was selected to measure financial performance. The results indicated that the primary independent variable (FDR) is still positive and economically significant.

#### CONCLUSIONS

The study's goal was to see how women's representation in corporate boardrooms affected the performance of selected banks in Ethiopia. Data was collected from annual reports of the selected banks over eight years (2013–2020). The results indicated that women's participation in the boardroom has immense economic benefits. The study's findings have implications for policymakers as well as banks. For example, female quotas in bank boardrooms might be mandated by policymakers, such as the national bank, which currently regulates the financial sector.

A legally mandated board quota requirement has been shown to be effective in many countries. And it may be emulated in Ethiopia. The national bank may also make it mandatory for banks to declare gender diversity initiatives, targets, and achievements in their annual reports. Banks should also rethink their board member recruitment and placement procedures to ensure the inclusion of educated and capable women on their boards.

The current study is limited in many ways. It only focused on diversity in terms of women's representation. Other aspects of board diversity were not investigated. Future research can broaden and extend the findings by including the multiple dimensions of diversity. Future research can also explore the effect of boardroom composition by assessing the effect of the inclusion of independent external women directors in the boardroom. The study only focused on banks. The result cannot be generalized to organizations in other



sectors. Researchers can consider the issue by drawing a sample from various organizations. The current study only assessed the representation of women in the boardroom. Further studies can determine how financial performance gets improved at different

levels of female boardroom representation. It may also be possible for profitable banks to selectively hire resourceful and capable women. Future researchers, in this regard, should investigate the possibility of reverse causation between the two variables.

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