



Theoretical Foundation for Board Heterogeneity in Contemporary Research

Dr Poonam Mahajan

Assistant Professor (Department of Commerce), Guru Nanak Dev University College, Narot Jaimal Singh, Pathankot.

Pradeep Kaur

Assistant Professor (Department of Commerce and Business Management), Guru Nanak Dev University Regional Campus, Gurdaspur.

Abstract

The present paper is a conceptual study highlighting theories behind the concept of board heterogeneity. Board heterogeneity is dynamic concept engulfing various traits, attributes and characteristics of board of directors which fuel organization's decision making and helps in maintaining competitive edge in the industry. However, this dynamic concept is multifaceted which can be explained through various social and cognitive theories such as Resource Dependence Theory, Agency Theory, Upper Echelons Theory, Social Identity Theory, Human Capital Theory, Tokenism Theory and Critical Mass Theory.

Key words: Board heterogeneity, theories, directors.

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I. Introduction

Board of directors take collective strategic decisions which are highly uncertain and involve huge amount of funds and each directors' decisions is influenced by his/her individual traits. Heterogeneity in corporate board has an impact on the decision-making ability of board of directors (Kagzi and Guha, 2018). The ethnic and gender representation like gender, race, nationality, knowledge and experience of board lead to improve organizational performance (Erhardt et al., 2003). Directors from diverse background provide access to resources, network connections, creativity, wider perspective and legitimacy but potential costs include conflict of interests, inadequate experience and qualifications. The heterogeneous group of directors explores various resources brought by individual directors for taking strategic decisions regarding innovational capabilities of firm.

Makhija (2020) established the importance of utilizing multiple theoretical perspectives for studying the curvilinear relationship of innovation with various diversities found in corporate boards. Resource based view, the agency theoretical view, communication and interaction view, social identity view, Upper Echelon theory are some of the theories used by majority of the authors to explain this contradictory and complex relationship. There is unavailability of single theory that provides justice to this concept. There is a dire need of multi-theoretical approach as evidenced by Makhija (2020). This study initiate on multi-theoretical approach which involves resource based view, dynamic capability view, agency view, cognitive diversity view, social identity view and corporate governance theories into one single approach based on their inter and intra interactions. In addition, moderating effects of interlocking directorates is studied on diversity-innovation capability relationship.

Researchers analysed how different traits of team members decide the appraisal of a team. Board of directors must guarantee the preservation of their intellectual assets to help in decision-making processes irrespective of their individual beliefs, opinions and faith. Resource based view focus on positive aspect of diverse corporate board but cognitive conflict view and social identity theory indulges the negative aspect. Multi-theoretical approach is required to consider these conflicting perspectives theories. Quality of decisions is derived from all these theories as how these components influence one another. Earlier studies were based on

surface level diversity namely visible differences such as gender, age and race but then scholars shifted focus to deep level diversity which is based on attributes not easily visible such as skills, socio-economic background, values and beliefs.

Need of the Study

The relevance of this study is multifaceted. It can help the organizations to make decisions regarding optimal and diverse board structure. Thorough knowledge of these theories can provide strategies to navigate boards with heterogeneous directors. It can encourage critical thinking and uniformity in thought. This study can also serve purpose to guide firms in complying with various rules, regulations and guidelines of enhanced governance practices. A comprehensive understanding and balance is must between theory and practice that can be developed by better knowledge of theories related to board heterogeneity. This study is also a step to foster continuous advancement in corporate governance research.

Objective of the Study

The objective of the study is to study the various theories related to Board Heterogeneity.

Theoretical Foundation

Here are some key theories that explain this dynamic concept:

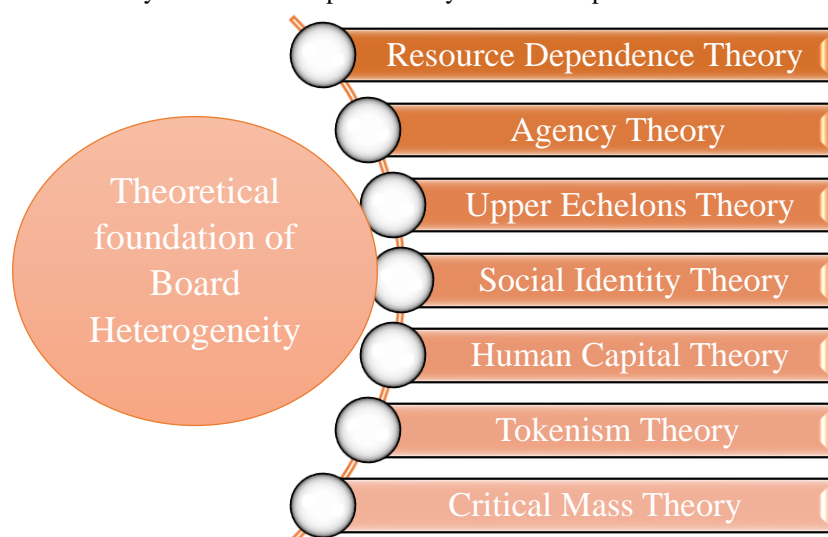


Figure 1 Theoretical Foundation of Board Heterogeneity

Source: Author's own compilation

1. Resource Dependence Theory

This theory advocates the significance of external resources for the development of the organization. This theory was established with the publication of *The External Control of Organizations: A Resource Dependence Perspective* (Pfeffer and Salancik, 1978). Resource Dependence Theory has ramifications for multiple facets of organizational strategy such as the ideal divisional configuration, the selection of board members and staff, production methodologies, contract frameworks, external organizational connections and numerous other elements of strategic planning (Hillman et al., 2009). It suggests that diverse boards provide a broader range of resources, knowledge and connections. Diverse board members can bring different perspectives, skills and networks that can be beneficial for the organization. It helps the company manage its dependencies and uncertainties in the external environment (Ariff et al., 2017). Diversity among board members nourish organization with multidimensional resources that can provide competitive edge to an organization.

2. Agency Theory

Agency theory examines the relationship between principals (shareholders) and agents (executive director) focusing on the conflicts that arise due to differing goals and the difficulties in monitoring agents' performance (Shapiro, 2005). The board of directors serves as an intermediary to mitigate these conflicts by monitoring and guiding executive management. A heterogeneous board brings a variety of perspectives, experiences and skills. This diversity enhances the board's ability to monitor and advise management effectively as members can identify and address a wider range of issues.

Diversity in the boardroom leads to more comprehensive and robust decision-making. Different viewpoints can reduce groupthink and improve the quality of decisions, aligning management actions more

closely with shareholders' interests. Diverse boards are often better at monitoring executive behavior because members are likely to question decisions and actions more rigorously (Poletti-Hughes and Briano-Turrent, 2019). This reduces the likelihood of executives acting in their own interests rather than those of the shareholders. Even though, some conflict is beneficial for avoiding groupthink but excessive conflict can hinder board effectiveness. It is important to balance diversity with cohesion to ensure productive and constructive interactions.

Integration of diverse environment and creating an inclusive environment is such a huge task to enjoy advantages of board heterogeneity. Agency theory highlights the importance of board heterogeneity in mitigating agency conflicts, improving decision-making and enhancing overall corporate governance (Musa and Ibrahim, 2022). However, companies must manage the challenges associated with diversity effectively to overcome the challenges of board heterogeneity.

3. Upper Echelons Theory

Upper Echelons Theory posits that the characteristics and experiences of top executives and board members significantly influence organizational outcomes (Hambrick and Mason, 1984). It stated that the demographic and cognitive diversity of these leaders shapes their perceptions, decisions and ultimately the performance of the organization. The experiences, values and cognitive frames of board members influence information interpretation and strategic decisions. A heterogeneous board brings varied perspectives, leading to richer discussions and more innovative solutions. Diverse boards are likely to have varied risk appetites and strategic orientations. This diversity can result in more balanced and well-considered strategic choices as differing viewpoints are considered and reconciled.

This theory advocates that heterogeneous boards are more likely to foster creativity and innovation. Varied expertise and experiences of directors of corporate board can facilitate better ideas and approach to address organization's ability to innovate and stay competitive (Díaz-Fernández et al., 2020). Heterogeneous boards are able to better cater requirements of shareholders.

However, heterogeneous boards may give rise to conflicts in corporate boards due to difference in opinions. There is need to establish mechanism to resolve conflicts and maintain consensus as board members need to be better managed to handle board conflicts, reach consensus and make better decisions. It also establishes that board heterogeneity impacts organizational performance but on account effective management of board conflicts (Kanadli et al., 2018).

4. Social Identity Theory

Social identity theory state that people are shaped by their membership of social groups and it provide them glimpse of who they are in-group settings. It shows how being part of group impact their behavior and personality (Tajfel and Turner, 1979). This theory throw light on influence of heterogeneity on group dynamics, decision-making and overall performance of the firm (Trepte and Loy, 2017).

Board members get classified in in-groups and out-groups based on their similarities and differences. This classification will lead to favoritism of in-groups members and biased behavior with out-group members which will further hinder interactions, communication and collaboration within the board. It can also lead to inter-group conflicts due to difference in behavior, opinion and perspectives (Hogg, 2016).

However, heterogeneous boards from various social identities can introduce broader range of perspectives and approaches to problem solving which will also lead to creativity and innovative solutions to strategic problems (Ali et al., 2014). This diverse approach will foster inclusiveness, collaborative environment and reduce the risk of marginalization of out-groups.

Effective conflict management strategies are highly significant to address these issues. Effective handling of in-group conflicts can be key to enhance cohesion in heterogeneous groups. Boards can leverage diversity to build effective, efficient, cohesive and unified teams to cater stakeholders of the firm.

5. Human Capital Theory

Human Capital Theory posits that various attributes of individuals such as skills, experience and knowledge form part of human capital that are valuable as assets to improve firm performance (Fleischhauer, 2007). Board members with unique experiences can help to recognize market trends, identify opportunities and establish better innovative solutions to maintain competitive edge in the industry (Wang, 2022).

It is quite challenging task to bring diverse human capital on corporate board. It requires effective communication and team spirit among board members. Overemphasis on one type of expertise can lead to inefficiency in other aspects. There are many challenges in maintaining difference perspective and opinions in diverse boards (Strober, 1990). Developing strategies to foster constructive dialogue and consensus building is significant in building human capital of the firm. The value of human capital lies in its continuous development. Company need to invest in training, ongoing learning and adaptation with changing environment.

6. Tokenism Theory

Tokenism theory states hiring a person belonging to minority to group to give illusion of just treatment and appearance of heterogeneity (Kanter, 1977). Gender homogeneity is major issue of concern in today's male dominated corporate boards. Stichman et al. (2010) also concluded that female employees are often isolated and underrepresented by their peers. Tokenism found to be multifaceted phenomenon where quantitative explanation is not enough to explain its myriad complexities.

Zimmer (1988) stated that women often face more rigorous testing and scrutiny as compared to their male counterparts in workplace. The concept of tokenism hinder women's progress and change focus of attention from real issue of sexism in workplace and patriarchal society as whole.

Gender homogeneity is quite prevalent in Indian corporate board where women directors are appointed as token to satisfy the requirements of Indian Companies Act, 2013 which mandated presence of one-woman director in corporate board. It is required to remove tokenism from corporate boards to fully utilize the expertise, skills and consider opinions of women directors in corporate board.

8. Critical Mass Theory

Critical mass theory suggests that certain threshold of minority group need to be achieved for them to have voice in the decision-making. Critical mass representation of minority group will also influence organizational performance and improve effectiveness. Inability to achieve acritical mass will lead to marginalization and token status of minority group which will hinder their participation in decision-making (Dahlerup, 2006).

This type of corporate boards will provide different perspectives, inclusive environment and collaboration spirit among the board of directors. This change can lead to more robust discussions and better decision-making. Different perspectives will help to eliminate the problem of groupthink. It also helps to curb tokenism and marginalized status of minority group.

A critical mass of diverse board members can create a self-reinforcing cycle. Inclusive board can attract additional diverse talent strengthening the board's capabilities and fostering a culture of inclusion (Sarah and Mona, 2008). Nevertheless, it can be challenging especially in organizations with historically homogeneous boards. Intentional efforts in recruitment, succession planning and diversity initiatives are required to achieve this threshold. It is important to ensure that the critical mass represents various dimensions of diversity (e.g., gender, ethnicity, age, professional background) rather than focusing on a single characteristic. This balanced representation can maximize the benefits of heterogeneity

Application of Board Heterogeneity Theories

Following is some of the applications of board heterogeneity theories in present times:

1. Diverse boards enhance decision making in crisis management, improve resilience and provide better adaptability in uncertain times.
2. Heterogeneity promote Environmental, Social and Governance (ESG) goals as it provides better alignment of stakeholders and management aims in the long run.
3. Better balance of experienced and young directors allows seamless adaptation of digital transformation initiatives by incorporating a wide range of technological and market insights.
4. It also leads to increased innovation in products, services and business models by encouraging diverse ideas and creative solutions in corporate boards.
5. Company can visualize as forward thinking and socially responsible organization with heterogeneous boards.

It is highly essential to have heterogeneous boards in present times for strategic decision-making, creativity, innovation and to maintain competitive advantage in the industry

II. Conclusion

Theories such as Agency Theory, Upper Echelons Theory, Social Identity Theory, Human Capital Theory, Tokenism Theory and Critical Mass Theory collectively establish a comprehensive foundation for understanding the importance of board heterogeneity. These theories illuminate how diverse boards enhance decision-making, foster innovation, improve risk management and better represent stakeholder interests while also highlighting the challenges and dynamics of integrating diverse perspectives. They emphasize that genuine inclusion is crucial for leveraging the full benefits of diversity. Organizations can realize the significant advantages that a heterogeneous board brings to governance and overall performance by addressing the complexities and fostering an inclusive culture.

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