Board diversity as strategic choice and why it should matter to SMEs

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Board diversity as strategic choice and why it should matter to SMEs

Abstract

Purpose
Diversity in boards has gained attention as a reflection of societal imbalances. The purpose of this paper is to investigate the impact of diversity in terms of both gender and nationality in management boards of small and medium-sized enterprises (SMEs) on firm performance from an upper echelons perspective. We also examine how board-specific characteristics influence the structural makeup of boards in gender and nationality diversity terms.

Methodology
We focus on the UK because of its individualistic society and flexible labour market, and assess 309 SMEs in the manufacturing industry over 2009-2019. A 3-stage least squares (3SLS) estimator is used to analyse the data, the Shannon index to measure board diversity, return on assets as proxy for firm performance, and owner-manager presence, board member age and tenure are the board-specific characteristics of primary interest.

Findings
Both gender and nationality diversity contribute to firm performance and represent distinct upper echelon characteristics that change the cognitive and psychological dynamics of boards. Firms with larger boards do not perform better, but diverse boards reduce the narrowing view of CEOs. Yet the presence of owner-managers, despite their performance-enhancing contribution, holds firms back from benefitting from diversity as a strategic choice.

Originality/value
This study extends the upper echelons theory to include board diversity as an important aspect that should become more central in upper echelon thinking when understanding firm performance. Our findings suggest that theoretical developments in search of understanding firm behaviour must proceed by accounting for diversity and not simply focusing on decision-making styles.

Keywords: SMEs; upper echelons; top management teams; board diversity; gender diversity; nationality diversity; firm performance

1. Introduction
Legislation on gender balance in management boards has gained prominence for multinational corporations (MNCs) and the debate thereof is driven more by moral obligation rather than the potential positive impact on firm performance (Torchia et al., 2011). Nationality diversity is captured by equality of opportunity policies, despite being different concepts (Tatli, 2011).
which has led to the diversity–performance link being under-researched (Lauring, 2013; Nielsen and Nielsen, 2013; Quintana-García and Benavides-Velasco, 2016). Since small and medium-sized enterprises (SMEs) are exempt (e.g. in the UK and much of Europe) from reporting structural imbalances, even less is known regarding the contribution of gender and nationality diversity to firm performance in that firm-size bracket. While such institutional and policy-based exemptions potentially demotivate SMEs from increasing diversity, diversity in organisations is a reality (O’Leary and Weathington, 2006; Urbano et al., 2019) and understanding how it can be used as a strategic tool to improve firm performance and thereby benefit society at large needs addressing.

Diversity in boards reflects societal equality (Post et al., 2021), and as such, imbalances thereof could constrain the potential of SMEs. With SMEs substantially contributing to economic development and prosperity, their purpose has been extended to the resolution of societal ills (Kuratko and Audretsch, 2021). Indeed, SME entrepreneurship has been embraced “as a panacea for social and economic ills …” and “… expected to solve such diverse problems as poverty, gender power imbalances …” and so forth (Lashley, 2016, p. 75). The creation of social value, alongside economic and environmental goals is particularly pronounced in countries with high GDP per capita (Brieger and De Clercq, 2019) and underperforming SMEs restrain economies from achieving sustainable and inclusive economic growth. But for societal challenges to be recognised as opportunities, they must be commercially viable (Kickul and Lyons, 2020) and knowing the benefits of diversity and how they can be attained is vital for achieving sustainable growth and performance of SMEs.

In this paper we respond to the aforementioned call and explore whether board diversity in terms of both gender and nationality constitutes a strategic option SMEs can pursue and actively
manage to improve firm performance, thus motivating SMEs to correct any such imbalances. This question is of importance because it is the visible aspects of demographic groups that define the natural fault lines upon which decisions are made (Hafsi and Turgut, 2012; Jack and Lorbiecki, 2007; Tatli, 2011), expectations set (Weck et al., 2022) and abilities (mis)judged (Bordalo et al., 2019; Marlow and McAdam, 2013). As a result, managers see diversity as progressive, but have little understanding of how to put the concept into practice and benefit from inclusivity (Singh and Point, 2004; Tatli, 2011). This implies that boards lack imagination, creativity and impetus from outside. The irony is that diversity is found to compensate for such deficiencies (Hambrick et al., 1996; Horwitz and Horwitz, 2007; Stahl et al., 2009), which indicates internal resistance that restricts firms in pursuing diversity as a strategic choice to enhance firm performance.

Hambrick and Mason’s (1984) upper echelons (UE) theory promotes the idea that an organisation is a reflection of its leadership team who steer its strategic direction while at the same time being subjected to external forces and limited by its own thinking. Experiences, values and personal characteristics act as natural filters that restrict the field of vision, perception and interpretation of information and signals (Hambrick, 2007). Put differently, UE theory has “served as a catalyst for examining how executives’ characteristics and experiences shape their perceptions, choices, and actions in ways that ultimately impact a variety of firm outcomes” (Neely et al., 2020, p. 1030). Despite board members being in a position to influence board composition (diversity) and thereby organisational outcomes, the recognition of diversity as a possible factor with strategic importance is not part of the original UE model. Diversity in gender and nationality are late additions as is the consideration of structural characteristics (Carpenter et al., 2004). Looking at the value of diversity as a force for good and how to achieve it is therefore an aspect with theoretical and managerial implications. Indeed, such a premise is
derived from the conclusions of Neely et al. (2020), who insist that UE theory scholars should devote attention to its real-world applicability and apply UE theory to challenges that are relevant to strategic leaders today, of which diversity is undeniably so. We, then, address a lacuna in UE research and theorisation to establish the effects of board characteristics on diversity, and ultimately, the contribution of this to firm performance.

Notwithstanding our previous observations, however, diversity in SMEs is complicated and dependent on context (Nielsen and Nielsen, 2013; Rhodes et al., 2016; Zona et al., 2013), may detract from SMEs (Branicki et al., 2017). With management boards being smaller than those of MNCs, owner-managers occupying key positions (Bracci and Vagnoni, 2011; McAdam et al., 2004) and with CEOs defining the strategic direction (Heuvel et al., 2006; Ling et al., 2008), the concentration of power is more pronounced in SMEs (Van Gils, 2005) and so are the consequences of disagreement and disharmony within boards. In a business environment where external pressure and competitive forces are high, as has become the case for SMEs (Audretsch and Moog, 2022), executives under strain from job-related pressures take mental shortcuts that are confined by past experience (Hambrick, 2007). By using easily accessible knowledge to reach decisions, extensive filtering of information takes place. CEOs’ preference for making decisions in concert with close allies within the leadership team—the ‘dominant coalition’—has been well established (Carpenter et al., 2004; Ling et al., 2008). Guided by perception (Lefebvre et al., 1997), CEOs minimise interference from board directors (Heuvel et al., 2006). While this results in efficient processes and reduces the risk of a disharmony, it omits potentially valuable input that emerges from a board with diverse backgrounds and may lead to a preference for homogeneity within boards.
In order to examine the link between board diversity and performance, we investigate to what extent board-specific characteristics (ownership, board member age and tenure) condition or limit diversity. The UE theory captures the complexities associated with strategic decision-making and the factors that influence the process thereof. As Hambrick and Mason (1984) extend through Simon’s (1947) bounded rationality and Cyert and March’s (1963) dominant coalition concepts, firm outcomes are consequences of executives making strategic decisions/choices according to personal interpretations of reality and these interpretations derive from executives’ characteristics, whereby “the socio-demographic characteristics of executives can constitute satisfactory representations of their cognitive schemata” (Abatecola and Cristofaro, 2020, p. 117). To investigate the impact gender diversity and nationality diversity of boards (strategic choices) have on SME firm performance (outcome), and to understand the role board-specific characteristics play in the creation of diversity, we analysed data from 309 independent UK-based SMEs in the manufacturing industry over a period of 10 years. Using a 3-stage least squares (3SLS) regression model and accounting for reverse causality (the impact of diversity on firm performance and vice versa) as called for in UE research by Hambrick (2007), we find that both gender and nationality diversity have a significant positive impact on firm performance, and that the presence of owner-managers in boards is the most influential force in restraining boards from becoming diverse. We find divergent effects from various UE characteristics and unlike predictions from UE theory, larger boards in SMEs do not by definition perform better.

We contribute to the literature in three ways. First, we complement gender diversity with nationality diversity and demonstrate that both dimensions are distinct UE characteristics that capture observable and psychological aspects and merit more attention than has been attributed. Second, we expand the understanding of diversity to the context of SMEs and show that both
gender diversity and nationality diversity are relevant performance–enhancing factors of strategic importance. Third, we expand the UE theory by adding diversity as a concept that reverses the narrowing of perspectives adopted by CEOs. To alter their strategic choices, behavioural UE characteristics (ownership, board member age and tenure) have been identified as board-specific structural parameters that condition or limit the emergence of diverse boards. As such, we extend our knowledge of diversity from the UE perspective to enrich theory and provide suggestions for how it can be taken forward.

2. Theoretical Background and Hypotheses Development

By postulating that an organisation is the reflection of its leadership team, the UE perspective (Hambrick and Mason, 1984) establishes a link between board characteristics and firm performance. The characteristics the theory draws on consist of psychological and observable factors with observable factors being a proxy for underlying cognitive and value-based attributes (Carpenter et al., 2004). These characteristics affect firm performance directly and indirectly through collective strategic choices, which then translate into firm performance. Psychological UE characteristics that influence firms’ strategic direction have been associated with nationality as a reflection of childhood experiences that persist throughout adulthood (Geletkanycz, 1997; Nielsen and Nielsen, 2013), and gender diversity to categorise intrinsic preferences, such as women’s risk aversion relative to male counterparts (Perryman et al., 2016; Post et al., 2020). This suggests that information processing and prioritisation is a function of a psychological process embedded in demographic classification that affects the strategic outcome.

While there is a general agreement within the research community that diversity in MNC boards impacts firm performance, there is less agreement on the direction of the impact and the kind
of diversity that is most influential (Díaz-Fernández et al., 2020; García-Ramos and Díaz, 2021; Tatlı, 2011). Stahl et al. (2009) for instance, suggest that a distinction of observable and unobservable characteristics could be misleading and show that the relevance of the distinction between surface-level and deep-level characteristics is limited to communication effectiveness. Part of the problem is the presence of publication bias toward statistically significant results (Homberg and Bui, 2013), but equally important is understanding the sources of diversity in the first place (Nielsen and Nielsen, 2013) if diversity management is pursued as a strategic option expected to yield a return. Board-specific characteristics that are linked to psychological aspects and unconscious behaviours provide the structural information required to assess the factors defining board diversity.

Cognitive diversity bears the potential to enhance a firm’s performance through improved knowledge absorption and processing capabilities (Rhodes et al., 2016). It allows the cognitive gap of the CEO to be complemented with a suitable fit provided by other board members (Martinez and Aldrich, 2011) and is found to increase innovation (e.g. Bocquet et al., 2019; Hillebrand et al., 2020; Narayan et al., 2021) and creativity (Hambrick et al., 1996; Horwitz and Horwitz, 2007; Stahl et al., 2009). Performance enhancing effects linked to diverse boards are also found by Hambrick et al. (1996), but they come at the expense of efficiency in the decision-making process due to disharmony (Milliken and Martins, 1996) driven by cognitive disparity (Westphal and Milton, 2000). The consequences are a lack of co-operation, isolation of minorities and extended periods of decision-making (Horwitz and Horwitz, 2007; Kolev and McNamara, 2020). Diverse boards impact the strategic allocation of assets (Baysinger et al., 1991) and the significance of gender and nationality diversity goes beyond firm-specific needs (Johnson et al., 2013) and industry-specific characteristics driven by environmental forces (Brammer et al., 2007; Farrell and Hersch, 2005). Knowing what drives diversity is therefore
as important as the outcome itself to understand to what extent diversity is a manageable
performance-enhancing instrument.

At this point, a distinction between SMEs and MNEs is necessary. While processes in large
firms are structured with formal procedures in place to allow for auditability and governance,
SMEs outperform them in efficiency because of the absence thereof (Arrow, 1993; Storey and
Greene, 2010). Their smaller teams are faster in reaching decisions and teams rich in knowledge
and experience make better decisions (Rhodes et al., 2016). Although owner-managed firms
are more likely to have gender-diverse boards, they are less in favour of outside directors than
managerial firms (Johannisson and Huse, 2010; Nekhili and Gatfaoui, 2013) despite their
positive contribution to firm performance (Bjornali et al., 2016; Brunninge et al., 2007;
Dehaene et al., 2001). According to the UE theory, larger and more diverse boards increase the
cognitive base and therefore make better decisions, but values, beliefs and a strive for efficiency
can hold firms back from following this rationale. Hence, a trade-off between diversity as a
resource and diversity as a source of conflict must be made, and the source of board composition
understood.

2.1 Gender diversity and firm performance

Gender-specific group characteristics represent a socio-cognitive category that affects the
strategic direction boards take (Almor et al., 2019; Narayan et al., 2021; Post et al., 2020)
mainly through the beliefs either males or females have of themselves and the other gender
(Bordalo et al., 2019), as opposed to absolute gender differences. The presence of female board
members shifts the cognitive balance towards less risky strategies that are more open to change
(Post et al., 2020), innovation (Miller and Del Carmen Triana, 2009; Østergaard et al., 2011)
and social performance (Bear et al., 2010; Hafsi and Turgut, 2012). The cognitive heterogeneity
of gender diversity adds complexity to strategic decisions (Almor et al., 2019) and increases their quality (Kolev and McNamara, 2020) with long-tenured female board members in small boards being most influential (Post et al., 2020). Gender diversity enhances a firm’s capability to combine knowledge (Ruiz-Jiménez et al., 2014) and intensifies the effort to grow through knowledge creation rather than acquisition (Post et al., 2020). As such, an even gender balance is expected to maximise firm performance.

While diversity increases the cognitive base, gender imbalances can also lead to conflict from cognitive disparity being overlooked (Cooper et al., 2021). The consequence is a diminished contribution of affected board members (Nielsen and Huse, 2010) or the perception thereof (Weck et al., 2022). Rooted in evolutionary patterns of mankind, females are more protectionist, which results in precautionary behaviours, whereas males are more likely to seek competition (Lienard, 2011). Lienard (2011) further indicates that disparity in cognitive and behavioural patterns results in same-sex competition rather than competition between genders. Intra-gender micro-aggressions in leadership positions were observed by Mavin et al. (2014), who attribute such behaviours to the masculine order imposed by the dominance of male leaders. Whether it be the suppressed voice or intra-gender conflict, it is possible that gender diversity has a negative impact on firm performance.

Empirical evidence on the gender–performance relation is inconsistent, even more so for SMEs. From an UE lens, collective personality, emotions and other internal dispositions have been demonstrated to influence important strategic outcomes of firms (Park and Gould, 2017) and socio-demographic variables such as gender are increasingly seen as vital drivers of outcomes under UE thinking (e.g. Abatecola and Cristofaro, 2020). Gender diversity in boards widens cognitive base, perceptions and interpretations of situational settings leading to strategic
choices that differ from those reached by homogeneous boards. As board members in SMEs are assumed to hold fewer external appointments than their counterparts in MNEs, they are more behaviourally integrated, which, according to Hambrick (2007), improves social interaction and collaboration. They are therefore capable of minimising conflict and benefit from capabilities that increase knowledge processing and reduce risk. Accordingly:

H1: Gender diversity is positively related to firm performance

2.2 Nationality diversity and firm performance

Board members’ nationality reflects cultural values (Hofstede et al., 2010), tacit norms (Boone et al., 2019) and ways of reasoning carried forward from childhood experiences (Nielsen and Nielsen, 2013). The national origin influences decisions and behaviours at individual and aggregate levels and has been associated with positive effects on firm performance (Estélyi and Nisar, 2016; Nielsen and Nielsen, 2013), corporate entrepreneurship (Boone et al., 2019) and social performance (Harjoto et al., 2018). Nationality diversity is further associated with innovation (Aparicio et al., 2021; Bocquet et al., 2019) and international experience (Staples, 2007). The cognitive capabilities board members collectively possess turn nationality diversity into a strategic resource that links to firm performance. Indeed, MNEs are found to follow a board internationalisation strategy to enhance their information processing capabilities and resource acquisition (Greve et al., 2015) with resource variety leading to greater international engagement (Barroso-Castro et al., 2020). The appointment of foreign nationals to enhance firm performance is also found by Estélyi and Nisar (2016). Hence, the successful exploitation of nationality diversity is advantageous and based on a firm’s ability to identify and integrate foreign nationals.
The drawbacks come when individuals feel excluded and cannot identify themselves with values and norms imposed by majority board members (Westphal and Milton, 2000). Such barriers decline when social ties with majority group members exist (Westphal and Milton, 2000) and preconditions an alignment in the value system. Haas and Nüesch (2012) see cultural issues as a possible explanation for observing better performance in homogeneous football teams. The presence of cultural diversity as a barrier to social integration is also found by Stahl et al. (2009) in their meta-analysis. They conclude that nationality diversity increases in creativity are insufficient in offsetting the losses in firm performance resulting from conflict and disintegration.

Top management team nationality diversity has been both argued and demonstrated to positively underpin firm performance under various contingencies (e.g. long-tenure, munificent environments) (Nielsen and Nielsen, 2013), yet empirical evidence on the implications of nationality diversity on firm performance of SMEs is currently lacking. From an UE perspective, however, we expect positive outcomes to flow from national diversity. According to the UE perspective, nationality diversity influences the cognitive base and values of boards and thereby alters the strategic choices boards make by drawing from an extended pool of experiences, views and knowledge about resource acquisition. Indeed, Wu et al. (2019, pp. 304–305) contend that diversity (e.g. in nationality and national culture) “promotes information and decision-making advantages through better elaboration of task-relevant information among team members” thereby enhancing, and not impairing, firm performance. Similarly, foreign board members’ ability to process information and contribute to innovation, among other outcomes (e.g. Nielsen and Nielsen, 2013), also suggests that diverse boards benefit from an expansion in the field of vision, a reduction in selective perception and an improved ability to interpret information. National culture has been found to contribute to explaining differences
in executive decision-making (e.g. Crossland and Hambrick, 2011; Nielsen and Nielsen, 2013) and such diverse management teams are more prone to comprehensive thinking, a broader base of ideas, higher creativity and innovation (e.g. Nielsen and Nielsen, 2013). Accordingly, the presumption from UE theory is that national diversity ought to facilitate an increase in firm performance due to the aforementioned reasons:

H2: Nationality diversity is positively related to firm performance

2.3 Owner-manager presence and diversity

The argument that concentrated control over resources influences the resource itself (Pfeffer and Salancik, 1978) suggests that owner-managers with majority stakes in firms influence the degree of diversity in boards. Cordeiro et al. (2020) find that majority owners and incumbent board members seek the inclusion of female board members to consolidate their interests in corporate social responsibility. Nekhili and Gatfaoui (2013) confirm this correlation for non-foreign directors and identify a glass ceiling for female directors, which restricts women in achieving senior positions. The inclusion of female board members with attributes that reduce uncertainty is further driven by non-punitive laws designed to increase board diversity (Martínez-García et al., 2021). Consequently, the impact ownership has on board diversity goes beyond statutory requirements aimed at increasing the gender balance (Ben-Amar et al., 2013; Carter et al., 2010) and makes the presence of owner-managers a relevant factor in determining board composition and strategic outcomes.

The vested interest owner-managers have exceeds that of non-owner managers (Heuvel et al., 2006; McAdam et al., 2004) and the absence of a regulated governance mechanism (Van Gils, 2005) makes boards in SMEs more accountable than those of large firms. Owner-managers
have an interest in influencing the board composition more than non-owner managers and thereby determine psychological and observable UE characteristics that enter the boardroom. Although Hambrick and Mason (1984) argue that firm performance of owner-managed and non-owner managed firms is indifferent, for SMEs, where boards are smaller and power is more concentrated, the influence ownership exerts on board diversity is stronger than in larger firms (Rhodes et al., 2016). The mere presence of an owner-manager is sufficient to influence the strategic direction through the occupation of key positions (McAdam et al., 2004) and long-term orientation (Cassia et al., 2012). Furthermore, the selection of outside board members is based on the alignment with owners’ interests (Voordeckers et al., 2007) and leads to owner-managed firms with outside directors that are more committed and cohesive (Bettinelli, 2011).

We therefore expect that owner-managers pursue a strategy of independence and conflict avoidance through a reduction in diversity (Tatli, 2011), and predict a negative impact of owner-manager presence on diversity.

H3: Owner-manager presence is negatively related to gender diversity
H4: Owner-manager presence is negatively related to nationality diversity

2.4 Board member age and diversity

In their original work Hambrick and Mason (1984) indicate a positive correlation between age and risk avoidance. Support for this claim is provided by Xu et al. (2018), who analyse the probability of financial fraud associated with board member age. Strategies with uncertain outcomes – and diversity in the boardroom is one of them – are therefore less preferred by older board members. According to Lienard (2011), age is associated with the consolidation of an established position and results in the formation of alliances that reduce risk and uncertainty, which is best achieved through homogeneous grouping. The avoidance of risk is reinforced by
the greater weight that is attributed to potential losses relative to potential gains across all age
groups (Barkley-Levenson et al., 2013). Since board member age is also an indicator of relevant
business experience and associated with behaviours and attitudes (Hafsi and Turgut, 2012) that
have been established over time, the need for diversity to aid knowledge processing becomes
irrelevant. As a result, the neurological response and how opportunities are perceived and
prioritised are age dependent (Barkley-Levenson et al., 2013).

Bordalo et al. (2020) find evidence that the validation of opportunities is assessed through
experiences that are triggered by context-specific situations. Unfamiliar territory, such as
diversity as a means to improve decision-making, might therefore not be interpreted as an
opportunity, because context and positive associations are absent. Although overriding of
previous experiences is possible, it is the more recent experiences that gain most weight
irrespective of expert knowledge being made available (Malmendier, 2021). Given that risk is
inversely correlated with age, recent experiences of older board members are characterised by
risk aversion rather than experimentation. Since younger board members have a smaller
repertoire of previous experiences that visualises to them the consequences of undesired
outcomes, they are forced to rely on rational thinking and ideological principles. This makes
boards consisting of younger decision-makers more open to exploration and suggests that:

H5: Board member age is negatively related to gender diversity

H6: Board member age is negatively related to nationality diversity

2.5 Board member tenure and diversity

Tenure refers to the experience board members have accumulated within a given firm and over
time results in the narrowing down of perspectives (Hambrick and Mason, 1984). By being less
visible than age (Sun et al., 2021), tenure reflects the relevance of unobservable board
characteristics with surface-level characteristics decreasing and psychological aspects gaining
importance for longer tenured teams (Stahl et al., 2009). With macro-economic conditions
becoming more volatile and unpredictable (Kose et al., 2008), the experience board members
have accumulated within the firm is no longer sufficient to respond to the challenges imposed
by uncontrollable forces external to the firm. Although knowledge and experience have a
positive impact on team decision-making (Rhodes et al., 2016), this may not translate into
higher levels of diversity if experience diminishes the perceived benefit of alternative views.

Initially diverse boards that work in a stable relationship over prolonged periods of time,
consolidate (Narayan et al., 2021) and views may narrow down. As a result, culturally diverse
teams become less creative, communication becomes less effective and conflict intensifies
(Stahl et al., 2009). Despite the aforementioned glass ceiling women face, established female
board members exert a significant influence on board composition (Wang et al., 2021) and are
expected to reduce the barriers for women to be appointed to senior leadership positions. The
same rationale may apply to foreign board members, who seek to forge alliances with like-minded members as the natural fault lines. The complication comes with the shortage of suitable
board members who possess a cultural background that is consistent with established foreign
board members. However, as an extension of cultural diversity would result in a less integrated
board (Stahl et al., 2009), the avoidance of conflict prevents boards from becoming more
nationally diverse. Despite tenure representing a distinct cognitive profile that captures deep-level characteristics (Barroso-Castro et al., 2020), there is a lack of empirical evidence on the
effect of tenure on nationality diversity. We hypothesise that:

H7: Board member tenure is positively related to gender diversity
H8: Board member tenure is negatively related to nationality diversity

Figure 1: Hypothesised relations based on Hambrick and Mason’s (1984) upper echelon perspective

3. Method

We use a dataset from the Bureau van Dijk’s Fame database, which covers firm-level data of manufacturing SMEs registered in the UK. The UK has the advantage of being a highly individualistic society, which results in a prioritisation of individual needs over social norms (Brieger and De Clercq, 2019), and a labour market that is less regulated compared to its European neighbours (IBP, 2015). This gives firms the autonomy to make more deliberate decisions when appointing board members and suggests that the presence of diversity results in multiple views that are exposed.

The dataset includes financial information and characteristics at board member level such as gender, nationality, date of appointment, date of birth and whether board members are also shareholders. Due to the context-dependency of firm growth determined by national institutional settings (Audretsch et al., 2006) and industry-specific factors (Hafsi and Turgut, 2012; Mateos de Cabo et al., 2012; Nielsen and Nielsen, 2013; Zona et al., 2013), the sample
consists of a single industry as classified by the UK SIC (2007) industry classification. The manufacturing sector has the benefit of historically rich and reliable data (Steinberg, 2016), complex processes (Alkan et al., 2018; Carlson et al., 1993) that challenge the cognitive capability of board members, and being investment intensive meaning that strategic choices made by boards have lasting effects on firm performance. The state of competition within an industry as well as external pressures affect the behavioural integration of boards and force board members to collaborate (Hambrick, 2007), which supports the case for an analysis at industry level.

In accordance with the firm-size definition of SMEs provided by the European Commission (2021), only firms with at least 10 employees and fewer than 250 were considered (see Table 1). Additionally, the independency of firms was considered, which resulted in the exclusion of firms not controlled by individuals. This is to ensure that firms considered in the sample are free to make deliberate strategic choices and are not restricted or superseded by corporate policies. After eliminating observations with missing data and moderating distortive effects of outliers by winsorising at the 0.05 level to achieve robust standard errors (Blaine, 2018; Kokic and Bell, 1994), the final sample consisted of 309 firms with data ranging from 2009 to 2019. While all financial data are time-variant, board characteristics are time-invariant.

Table 1: Sample characteristics

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<th>N</th>
<th>Percentage</th>
<th>Number of employees</th>
<th>Firm age</th>
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<td></td>
<td></td>
<td></td>
<td>Mean</td>
<td>Std. Dev.</td>
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<td>Small firms (10-49 employees)</td>
<td>39</td>
<td>13%</td>
<td>34.907</td>
<td>10.878</td>
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<tr>
<td>Medium-sized firms (50-249 employees)</td>
<td>270</td>
<td>87%</td>
<td>106.976</td>
<td>42.085</td>
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<tr>
<td>Total sample firms</td>
<td>309</td>
<td>100%</td>
<td>97.816</td>
<td>46.485</td>
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3.1 Model specification and variables
Since most board-specific parameters are endogenous (Adams et al., 2010; Neely et al., 2020), we formulated a simultaneous equation system to analyse the impact of gender diversity and nationality diversity on firm performance. Nationality diversity is operationalised as the ratio of domestic and non-domestic board members based on the nationality retrieved from the dataset. We predicted that diversity in terms of both gender and nationality affects firm performance, but it could also apply that firm performance influences diversity in boards (Smith et al., 2006). In econometric terms, reverse causality must be considered (Hambrick, 2007; Neely et al., 2020), which favours a simultaneous equation system over the conventional ordinary least squares (OLS) approach. While the simultaneous equation system is still bound to the assumptions applicable to the OLS estimator—except for the aforementioned direction of causality—, it requires a high R² of the estimate equations that enter the final stage of the estimation process (Asteriou and Hall, 2016). Compared to 2SLS, 3SLS has the additional benefit of taking into account cross-equation interdependencies (Zellner and Theil, 1962). The estimation method has been used in prior studies to assess the impact of gender diversity and nationality diversity on performance-related dimensions (e.g. Carter et al., 2010; Mínguez-Vera and López-Martínez, 2010; Zaid et al., 2020). The structural form of our model follows the rationale adopted by Carter et al. (2010) and Jackling and Johl (2009), and is defined as:

\[
\text{PERF}_i = \alpha_0 + \alpha_1 \text{YEAR}_t + \alpha_2 \text{L.PERF}_{it-1} + \alpha_3 \text{GENDER}_i + \alpha_4 \text{NATIONAL}_i + \sum_{j=5}^{7} \alpha_j \text{BOARD}_{j,i} + \sum_{j=8}^{12} \alpha_j \text{CV}_{j,i} + \epsilon_{it}
\]

(1)

Accordingly, \( \text{PERF} \) means firm performance measured by the return on assets ratio (ROA), \( \text{YEAR} \) represents year dummies, \( \text{L.PERF} \) past firm performance at \( t-1 \), \( \text{BOARD} \) includes board-specific independent variables and \( \text{CV} \) captures firm-specific control variables; \( \epsilon \) is the time-variant error term that captures unobserved effects that could affect firm performance. \( \text{GENDER} \) and \( \text{NATIONAL} \) represent gender diversity and nationality diversity respectively.
Both variables are measured using the Shannon diversity index – identified by Campbell and Mínguez-Vera (2007) as a suitable alternative to percentage and dummy-based diversity measures – and are determined by the estimated parameters extracted from equations (2) and (3):

\[
GENDER_{it} = \beta_0 + \beta_1 YEAR_{it} + \beta_2 PERF_{it} + \beta_3 FM_{it} + \sum_{j=4}^{6} \alpha_j BOARD_{ji} + \sum_{j=7}^{11} \beta_j CV_{ji} + \varphi_{it}
\]

\[
NATIONAL_{it} = \gamma_0 + \gamma_1 YEAR_{it} + \gamma_2 PERF_{it} + \gamma_3 FD_{it} + \sum_{j=4}^{6} \gamma_j BOARD_{ji} + \sum_{j=7}^{11} \gamma_j CV_{ji} + \omega_{it}
\]

Gender diversity and nationality diversity are determined by firm performance (PERF) to account for possible interaction effects and reverse causality, board-specific characteristics (BOARD) and firm-specific control variables (CV). The number of female board members (FM) and foreign board members (FD) are the instrumental variables employed to ensure the independent distribution of the explanatory variables, including the error terms \(\varphi\) and \(\omega\) required to capture unobserved heterogeneity from omitted variables.

### 3.2 Dependent variables

Consistent with prior research on firm performance and board diversity (Carter et al., 2010; Escribá-Esteve et al., 2009; Mínguez-Vera and López-Martínez, 2010; Nekhili and Gatfaoui, 2013), we use ROA defined as profit before tax to total assets to measure firm performance. While being superior to ROS and ROE (Huybrechts et al., 2016), the pre-taxation measure also reduces distortionary effects from unequal taxation across firm-size classes.

The Shannon index as a measure for diversity reflects the idea of diverse boards as an UE characteristic, whereas a percentage measure suggests that a management team consisting of women or foreign directors is by definition better than any combination. The value of the
Shannon index is smallest when a board consists of either all female or male board members and highest for equal representation of each demographic group [based on the formula provided by Campbell and Minguez-Vera (2007), values move between 0 and 0.69]. Instead, the percentages of female and foreign board members is used as instrumental variable, because it is highly correlated to the dependent diversity variables and least correlated to any explanatory variable, including the residuals.

3.3 Independent variables

While gender diversity and nationality diversity act as both dependent [equations (2) and (3)] and independent [equation (1)] variables that reflect group heterogeneity, board-specific characteristics (BOARD) are expected to explain group heterogeneity as well as firm performance. The board characteristics of primary interest are the influence of owner-managers, board member age and board member tenure, each of which can be associated with dimensions set in Hambrick and Mason’s (1984) original work. Owner-management presence refers to the financial position of board members and is defined as the percentage of board members who are also shareholders. Board member age is the proxy for openness to new approaches (Hambrick and Mason, 1984), proactiveness (Escribá-Esteve et al., 2009) and business experience (Hafsi and Turgut, 2012). Boone et al. (2019) and Xu et al. (2018) use the average age of directors and we follow the same approach. Board member tenure reflects firm and industry-specific experience (Escribá-Esteve et al., 2009) and is found to influence levels of cultural diversity (Stahl et al., 2009). It is a structural variable Hambrick and Mason (1984) have associated with acceptable perspectives being considered. Nielsen and Nielsen (2013) use the median and Boone et al. (2019) refer to mean and standard deviation. Consistent with Bao et al. (2014), we use the average number of years board members have been appointed to.
3.4 Control variables

We control for board size, firm age, turnover, financial risk and operational risk. As there is a higher probability of diverse boards when the number of active board members is large (Mateos de Cabo et al., 2012; Nekhili and Gatfaoui, 2013), board size becomes a relevant factor that plays a central role in UE theory (Carpenter et al., 2004). Firm age is found to carry explanatory power from its association with survival and inertia (Coad, 2018) as well as innovation (Pellegrino, 2018) and hence the strategic options. Our sample consists of firms with a trading history of at least 10 years and selection bias due to the underrepresentation of younger firms can be excluded. Strategic options (e.g. economies of scale and scope) and knowledge processing also depend on firm-size (Messeni Petruzzelli et al., 2018). Consistent with Reguera-Alvardo and Bravo (2017), we use turnover as a proxy for firm-size to control for such factors. Their findings also confirm the relevance of financial risk, defined as the natural logarithm of long-term debt over total assets. Exposure to financial risk is further associated with gender diversity as female board members are considered risk averse (Marinova et al., 2016; Mateos de Cabo et al., 2012; Rossi et al., 2017). Operational risk, measured as the standard deviation of ROA over the sample period (Mínguez-Vera and López-Martínez, 2010), is also expected to affect board diversity, because risky business environments are associated with a preference for group homogeneity (Mateos de Cabo et al., 2012).

4. Results

The descriptive statistics reported in Table 2 show the board composition in British manufacturing SMEs. The calculated female board member representation is 20%, which is 14.5% below the sector average at the end of the sample period (European Institute for Gender Equality, 2021). The difference is due to the high share of male-owned SMEs and less a sector-specific anomaly, meaning that large firms have more gender diverse boards. Even weaker is
the presence of foreign board members (6%). The average SME in our sample has a board size of 4.4 members (min. 1; max 11) with a mean board member age of 59 years (min. 41; max. 78), a mean board member tenure of 17 years (min. 1.5; max. 36) and most board members being owner-managers.
Table 2: Descriptive statistics and Pearson correlation matrix

<table>
<thead>
<tr>
<th>Variables</th>
<th>Mean</th>
<th>SD</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
<th>10</th>
</tr>
</thead>
<tbody>
<tr>
<td>ROA</td>
<td>7.298</td>
<td>7.649</td>
<td></td>
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<td></td>
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<td></td>
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</tr>
<tr>
<td>Gender diversity*</td>
<td>0.341</td>
<td>0.308</td>
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<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>No. of female board members</td>
<td>1.564</td>
<td>1.966</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Nationality diversity*</td>
<td>0.064</td>
<td>0.183</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>No. of foreign board members</td>
<td>0.241</td>
<td>0.885</td>
<td></td>
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</tr>
<tr>
<td>Owner-manager presence</td>
<td>0.566</td>
<td>0.332</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Board member age</td>
<td>58.93</td>
<td>6.479</td>
<td></td>
<td></td>
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<td></td>
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<td></td>
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<td></td>
</tr>
<tr>
<td>Board member tenure</td>
<td>16.79</td>
<td>6.988</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Board size</td>
<td>4.405</td>
<td>1.935</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>Firm age (ln)</td>
<td>3.683</td>
<td>0.553</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Turnover (ln)</td>
<td>9.394</td>
<td>0.520</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial risk (ln)</td>
<td>2.904</td>
<td>1.813</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operational risk</td>
<td>1.603</td>
<td>0.642</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

N = 309. [13% small firms (10-49 employees), 87% medium-sized firms (50-249 employees).] Significance levels: *** p < 0.001, ** p < 0.05, * p < 0.1

a) Shannon index
Following Hambrick and Mason’s (1984) theoretical framework, the regression results shown in Table 3 columns 1 to 3 reveal that gender diversity ($b = 0.676; p < 0.10$) and nationality diversity ($b = 2.754; p < 0.001$) are directly related to firm performance and significant, but the impact of nationality diversity has on firm performance is four times that of gender diversity. Analysis reveals neither gender diversity nor nationality diversity is determined by firm performance, which rejects the case for reverse causality. As the F-statistic suggested that board member age and board size should be excluded from equation 1 due to the noise these variables add, columns 4 to 6 report the restricted model. Similarly, the decision to exclude firm performance and financial risk as explanatory variables from equations 2 and 3 is based on the F-statistic and makes the inclusion of year dummies redundant. The significance of gender diversity ($b = 0.660; p < 0.10$) and nationality diversity ($b = 2.761; p < 0.001$) remains unaffected and the coefficients show marginal variations in the magnitude. We verified the estimates obtained through independent equations using robust standard errors. Significance and direction of the coefficients obtained from the 3SLS estimation have been confirmed. We therefore find support for H1 and H2.

Table 3: Regression results for firm performance

<table>
<thead>
<tr>
<th>Dependent Variable</th>
<th>Unrestricted model</th>
<th></th>
<th></th>
<th>Restricted model</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
<td>(4)</td>
<td>(5)</td>
<td>(6)</td>
</tr>
<tr>
<td></td>
<td>Firm performance</td>
<td>Gender Diversity</td>
<td>Nationality Diversity</td>
<td>Firm performance</td>
<td>Gender Diversity</td>
<td>Nationality Diversity</td>
</tr>
<tr>
<td>Year dummies</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>Past performance</td>
<td>0.636***</td>
<td></td>
<td></td>
<td>0.636***</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Firm age</td>
<td>-0.267</td>
<td>0.000†</td>
<td>0.000²</td>
<td>-0.268</td>
<td>0.000³</td>
<td>0.000³</td>
</tr>
<tr>
<td>Turnover</td>
<td>1.300***</td>
<td>0.031***</td>
<td>0.004</td>
<td>1.303***</td>
<td>0.028***</td>
<td>0.003</td>
</tr>
<tr>
<td>Financial risk</td>
<td>-0.387***</td>
<td>0.001</td>
<td>0.000</td>
<td>-0.386***</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operational risk</td>
<td>1.109***</td>
<td>-0.030***</td>
<td>0.00850**</td>
<td>1.111***</td>
<td>-0.0307***</td>
<td>0.009***</td>
</tr>
<tr>
<td>Gender diversity</td>
<td>0.676*</td>
<td></td>
<td></td>
<td>0.660*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nationality diversity</td>
<td>2.754***</td>
<td>-0.068***</td>
<td>-0.042***</td>
<td>1.111**</td>
<td>-0.068***</td>
<td>-0.042***</td>
</tr>
<tr>
<td>Owner-manager presence</td>
<td>1.104**</td>
<td>-0.068***</td>
<td>-0.042***</td>
<td>1.111**</td>
<td>-0.068***</td>
<td>-0.042***</td>
</tr>
<tr>
<td>Board member age</td>
<td>-0.002</td>
<td>0.003***</td>
<td>0.000</td>
<td>0.003***</td>
<td>0.003***</td>
<td>0.000</td>
</tr>
<tr>
<td>Board member tenure</td>
<td>0.028</td>
<td>0.000</td>
<td>-0.001***</td>
<td>0.028*</td>
<td>0.000</td>
<td>-0.001***</td>
</tr>
<tr>
<td>Board size</td>
<td>-0.010</td>
<td>-0.041***</td>
<td>-0.005***</td>
<td>-0.041***</td>
<td>-0.005***</td>
<td></td>
</tr>
</tbody>
</table>
Although firms gain economic benefits from diverse boards, the aim of this study is also to investigate whether board-specific characteristics facilitate diversity or impose limitations to it. These UE characteristics (owner management, board member age and tenure) show varied effects on the diversity dimensions.

*Owner-manager presence* exceeds the contribution to firm performance of non-shareholding board members (b = 1.111; p < 0.05), but, and consistent with H3 and H4, the presence of owner-managers has a negative impact on gender diversity (b = -0.068; p < 0.001) and nationality diversity (b = -0.042; p < 0.001). The results are consistent across both the unrestricted and restricted models.

*Board member age* was expected to have a negative effect on diversity due to conservatism and less experimental approaches board members adopt over time. Only the degree of gender diversity is positively related to board member age (we predicted a negative relation). With the mean board member age of 59 years (SD 6.58), this result is unexpected and rejects H5 and H6. Equally insignificant is the direct link of board member age and firm performance.

*Board member tenure* influences firm performance directly (b = 0.028; p < 0.10) and indirectly through the significant impact on nationality diversity. While there is no significant direct impact
on gender diversity, the direct effect on nationality diversity is negative and weak ($b = -0.001; p < 0.001$). Again, the findings are consistent across both model specifications and reject H7, but do not reject H8.

The control variables give further insights into the forces that drive firm performance and diversity. Since *board size* does not directly affect firm performance ($b = -0.010; \text{n.s.}$), SMEs with larger boards do not perform better than those with smaller boards. Although firms size in terms of *turnover* is a driver of firm performance ($b = 1.303; p < 0.001$) and gender diversity ($b = 0.028, p < 0.001$), larger boards in SMEs reduce the presence of female board members ($b = -0.041; p < 0.001$) and foreign board members ($b = -0.005, p < 0.001$). We find a similar yet negligible mediating effect for *firm age*, which affects firm performance only indirectly by lowering gender diversity ($b = -0.0003; p < 0.05$) and increasing nationality diversity ($b = 0.0002; p < 0.05$). Accordingly, older firms are less diverse and, paradoxically, more open to nationality diversity.

Finally, *financial risk* (a firm’s exposure to debt) lowers firm performance ($b = -0.386; p < 0.001$) and does not influence board diversity. *Operational risk* (variance in ROA) however, is associated with higher firm performance ($b = 1.111, p < 0.001$), less gender diversity ($b = -0.031; p < 0.001$) and more nationality diversity ($b = 0.009; p < 0.05$).

### 4.1 Robustness check

To ensure the validity and reliability of the estimates obtained, only variables with a variance inflation factor (VIF) below 2 were used (e.g. Nekhili and Gatfaoui, 2013). The mean VIF values for equations (1), (2) and (3) are 1.52, 1.58 and 1.55 respectively. We checked whether past performance at t-1 or t-2 has an impact on gender diversity or nationality diversity and found that
neither does. We used robust standard errors to address heteroscedasticity issues not captured by the model specification and the less sensitive Blau index (ranging from 0 to 0.5) adopted by Bear et al. (2010), Nielsen and Nielsen (2013) and Sun et al. (2021) to verify the significance of our findings. Significance, direction and relative magnitude of the coefficients obtained from the estimates based on the Shannon index have been confirmed.

5. Discussion

Adopting the UE perspective, the aim of this study was to identify the effect diversity in terms of both gender and nationality has on SME firm performance and whether board-specific characteristics condition or limit diversity. We have argued that observable UE attributes establish the fault lines upon which decisions about diversity in boards are made and that they reflect deep-level characteristics. Equally important are board-specific factors that capture attitudes and behaviour of incumbent board members, who have an intrinsic motivation to influence the board composition in accordance with their preferences based on values and cognitive base. We find that gender diversity and nationality diversity have a direct and positive effect on firm performance, while owner-managers are the single most influential force in restricting boards from becoming more diverse. Board member tenure has negative implications for nationality diversity and board member age does act to benefit gender diversity. We now proceed to discuss the implications of the results prior to concluding.

5.1 Implications for Theory

The UE perspective attributes significant influence on strategic choice and firm performance from the leaders of the firm (Hambrick and Mason, 1984) and is based on the premise that strategic
decisions are the result of various behavioural and characteristic factors (Finkelstein and Hambrick, 1990). Importantly, it recognises that executives act on the basis of their own interpretation of strategic situations and their perspectives are influenced by demographic characteristics and prior experiences (Hambrick, 2007; Hambrick and Mason, 1984) whereby “the socio-demographic characteristics of executives can constitute satisfactory representations of their cognitive schemata” (Abatecola and Cristofaro, 2020, p. 117). From the point of view of UE theory, then, characteristics influence strategic decision and actions that then drive firm outcomes (Abatecola and Cristofaro, 2020; Hambrick and Mason, 1984; Neely et al., 2020; Wu et al., 2019).

Diversity at the board level changes the cognitive and psychological dynamics of the board. As such, we extend thinking around the UE perspective to include board diversity, in gender and nationality terms, as important UE aspects that must be considered in the conversation when understanding firm performance.

Our results for gender diversity suggest that the positive impact on firm performance is down to cognitive and behavioural aspects. Firms with lower operational risk attract gender diversity (see Table 3). This supports Lienard’s (2011) argument that female board members are risk averse and, consistent with Marlow and McAdam (2013), run firms differently and not worse. The presence of female board members rebalances the cognitive monotony of homogeneous boards (Adams and Ferreira, 2009; Ruiz-Jiménez et al., 2014) and even minority constellations influence the strategic direction (Wang et al., 2021). In conjunction with previous findings (Moreno-Gómez et al., 2018; Perryman et al., 2016), our study should encourage firms to become more open to gender diversity and observe the contribution female board members can make to firm performance, but moreover, theoretical developments in search of understanding firm behaviour must proceed by accounting
for diversity and not simply focusing on decision-making styles as we can be confident from UE
theory that such styles are being driven by UE and board-specific characteristics.

We also propose to extend the focus of board diversity to nationality diversity as a distinct UE
characteristic in the spirit of calls by Hambrick (2007) for theoretical development around the role
of nationality in UE theory. Since gender diversity and nationality diversity differ in
conceptualisation (Carter et al., 2010), they complement one another. The direct and indirect
impact operational risk exerts on firm performance [see Table 3] testifies to the cognitive capability
international teams bring to the boardroom. Firms with a higher operational risk consist of boards
that are nationally more diverse, improve firm performance and are superior in managing such
risks. This suggests that national teams draw their success from a wider cognitive base that allows
them to interpret and process information in a way homogeneous boards cannot replicate. While
the presence of female board members is conditioned by firm-size (the correlation of which is
0.028 at p < 0.001), larger boards do not deliver better economic performance. Rather, it is the
variation in perspectives and cognitive abilities that are brought into the boardroom through gender
and nationality that add value until a saturation in perspectives is achieved. The importance of
diversity in boards as a means to reduce cognitive gaps increases with firm age (Martinez and
Aldrich, 2011). This gives reason to believe that gender diversity and nationality diversity are
important UE characteristics, represent distinct socio-cognitive groups and qualify as a strategic
choice with a direct effect on firm performance.

Assuming owner-managers act in the interest of the firm, and the direct and positive influence they
have on firm performance shows this, they are expected to show traits of an inclusive leader who
treats diversity as a strategic choice and makes diversity work. It appears, however, that owner-
managers wish to stay in control to ensure effective decision-making (Brammer et al., 2007; 
Horwitz and Horwitz, 2007; Tatli, 2011) and that tenure too is a limiting factor that suppresses the 
emergence of nationality diversity. This position is in contradiction with findings from Campbell 
and Mínguez-Vera (2007) and Mínguez-Vera and López-Martínez (2010), and highlights deeper 
rooted structural challenges that hinder innovation (McAdam et al., 2004) and strategic change 
(Brunninge et al., 2007). One UE interpretation is the concentration of CEO power and the 
narrowing of perspectives that goes with it. The stronger the CEO, the weaker the benefits of 
diverse boards in firm performance (Estélyi and Nisar, 2016) and capability building (Sun et al., 
2021). CEO power is also associated with the status attributed to female directors and the ease at 
which female board members are involved (Weck et al., 2022). Given the likelihood of owner-
managers being high in SMEs, UE research must strive to theorise further why negative effects 
are in play for board diversity in this scenario.

Homogeneous (non-diverse) boards indicate that board members are not nominated according to 
qualification (Carver, 2002) and a possible explanation for the positive relation of board member 
age and gender diversity is the progression of female employees who move to senior roles. In line 
with Biswas et al. (2021), we expected that once female board members are in a favourable 
position, they become influential, consolidate their position and thereby contribute to gender 
diversity. The findings, however, show that tenure does not lead to greater levels of gender 
diversity and confirm the presence of a glass ceiling (Nekhili and Gatfaoui, 2013). Gender diversity 
is therefore not the result of a proactive strategy.
Regarding future theoretical developments into UE diversity, we know that diversity in SMEs is complex and may detract from SMEs by eroding what makes SMEs entrepreneurial, which is their resilience and ability to operate in uncertain environments by exploiting the efficiency of informal structures (Branicki et al., 2017). That is, there are contextual variations likely in the benefits of diversity. Our findings do shed some light for theorising around SMEs by revealing the beneficial outcomes of diversity coupled with drivers and detractors of diversity at the board level, which upholds that diversity should be considered from an UE perspective and formalised. For further theorising and theoretical development, diversity should become more central in UE thinking and more incorporated in UE theory as opposed to UE researching.

5.2 Implications for Practice

With an average tenure of 17 years, the boards in our sample are relatively stable and the type of conflict board members encounter can be anticipated. This, according to Rink and Ellemers (2007), constitutes a pre-condition for identification and belonging. By giving equal weight to alternative views, such constellations become permanent and sustainable (Jack and Lorbiecki, 2007). Diversity can then become a device that empowers owner-managers to strategically manage intended conflict. As controlled discourse becomes a means to establish a corporate culture that builds on the idea of identity and belonging, constructive conflict eventually translates to board member commitment and improved firm performance. Mitchell et al. (2015) find support for the positive influence on team performance diverse groups have when managed by an inclusive leader who recognises the relevance of identity and differences in individuals’ status. Although coopetition is one of the features observed in collaborative teams within organisations (Kourtì, 2021), our results suggest that the benefits outweigh the drawback caused by conflict.
Extended board member tenures do detract from the nationality diversity of boards, which in turn has a knock-on effect on firm performance. Though age does have positive effects on gender diversity. SMEs need to give careful consideration here while diversifying the board and the nature of the diversification they are seeking to achieve. Coupled with findings for owner-managers, it is apparent that achieving nationality diversity is trickiest for SMEs, yet, this confers the strongest potential benefits for firm performance in our findings.

Implementing diversity in practice must go beyond a simple box-ticking exercise. According to Herring (2009), it is the provision of training in managing diversity that removes the negative impact of diverse team outcomes. Since board membership is associated with an elevated educational background (Gray, 2006; Gregorič and Poulsen, 2020), board members are in a better position to manage conflict than the average employee. Board members oversee a wider range of resources and their actions are more visible and consequential (Forbes and Milliken, 1999). It is in each board member’s interest to contribute to a functioning decision-making unit, to resolve tensions when they arise and allow for positive conflict to occur. The motivation associated with the responsibility board members in SMEs have, triggers a search for creative solutions (Amabile, 1988) and explains the positive link between group heterogeneity and firm performance. Educational background may also result in more dialogue, which is a key enabler in overcoming conflict linked to competing value systems (Gurteen, 1998). Here the smallness of SMEs contributes to the success of diverse teams (Post et al., 2020). Smallness facilitates discourse, and because the marginal contribution each board member makes is greater than that in large firms, it reduces the probability of voices not being heard (Cooper et al., 2021; Nielsen and Huse, 2010).
and tokenism being practiced (Wang et al., 2021). The mean board size of 4.4 board members observed in our sample attributes relevance to those arguments and gives SMEs the structural advantage of being more inclusive, as was argued by Zona et al. (2013).

We provide clear support for increased firm performance for SMEs arising from diversity in terms of both gender and nationality, which supports arguments for policy interventions to improve diversity at the SME level (especially so given the value of SMEs globally to country-level economies and the global-level economy more widely). Indeed, if a lack of diversity in boards reflects societal inequality and constrains the potential of SMEs, policies designed to rebalance societal representation in boards are needed. As target setting and imposing quotas is counterproductive (Hoang et al., 2022), a softer yet assertive approach that supports SMEs in recognising the value of diversity should be pursued. Such policies would include educational measures that focus on the awareness of the value associated with diverse perspectives and how diversity translates into economic performance. Coaching and mentoring schemes alongside incentives that encourage the incorporation of diversity in firms’ mission might be considered in order to achieve a long-term cultural shift toward openness and acceptance. The positive promotion of women in business and of diverse nationalities in business should now be emphasised. From this, we argue there is scope now for institutional engagement in monitoring levels of diversity across all firm sizes and thereby contribute to the foundation of an inclusive society. Not just because there is a moral obligation, but because our findings suggest improvements in firm performance that make this a business and economic imperative.

5.3 Limitations and future research
Our study comes not without reservations. First, the context-specific nature of the diversity–performance relation required us to restrict the scope to a single industry. As the econometric model deployed is based on asymptotic symmetry, we focused on an industry with a rich dataset. In developed economies the manufacturing sector accounts for a relatively small share and most firms operate in a mature industry-life cycle stage, which nonetheless is a source of complexity. Investigations that focus on younger and more dynamic industries should be considered, given that diversity is influenced by the business environment (Brammer et al., 2007; Estélyi and Nisar, 2016). Future research may also look at other sectors and the difference between small firms and medium-sized firms. Second, the econometric model deployed is parametric in nature and a non-parametric approach that is better suited to examine the role of mediators is welcome. While some conclusions on mediating effects could be drawn, the main reason to use a 3SLS system equation was the necessity to determine the significance of reverse causality and control for cross-equation effects. Given that reverse causality turned out to be insignificant, a different approach should be considered. Third, board diversity measures accessible to us are time-invariant and although boards in SMEs are more stable than those in larger firms, time-variant data would result in a more comprehensive analysis. This includes the variation of the contribution of diversity along the firm growth pathway, especially when SMEs transition to manager-led organisations. This turns diversity into a dynamic concept and reveals its role at various stages. After all, board compositions vary over time and so do the cognitive demands in volatile business environments. Fourth, we used firm performance as the outcome variable and argue that gender and national diversity alter the cognitive base. It is, however, inappropriate to associate bad performance to poorer decisions. While decisions could be right, the board is incapable of seeing new viewpoints due to a lack of diversity. The mechanics of the decision-making process in UE theory—known as ‘black box’
problem—are not yet fully understood (Neely et al., 2020). We encourage qualitative work to assess how diversity influences the decision-making process at each stage (i.e. the field of vision, selective perception, interpretation) and the quality of decisions boards reach. Formal as well as informal structures and processes may play a role. We also recommend to investigate which governance mechanisms are most effective in establishing and monitoring diversity in boards of SMEs. Fifth, we acknowledge Hambrick’s (2007) point that demographic characteristics of executives can be used as valid (though incomplete and imprecise) proxies of executives’ cognitive frames. It would be interesting to know how networks can be used to fill cognitive gaps. Little research has been conducted in connection to diversity and how network-effects assist in identifying board members that best fit firms. As such, future research should take on these limitations and expand on UE theory from the presented here.

6. Conclusion

The aim of this study was to assess diversity as a strategic choice for SMEs and how to achieve it through structural conditioning to overcome the barriers board-specific characteristics impose. We demonstrate that diversity in terms of both gender and nationality in SMEs has a positive impact on firm performance and provide evidence that this is linked to distinct socio-cognitive attributes. Both gender diversity and nationality diversity sit at the intersection of psychological and observable UE characteristics and our findings underline the importance of forms of diversity as UE characteristics. By altering the cognitive base to acquire and process information, combined with demographic values, diversity in the boardroom widens the vision of the leadership team. We further demonstrate that ownership, age and tenure are significant board-specific characteristics that influence board composition. The presence of owner-managers is the single most important
factor that hinders boards from becoming more diverse. Despite owner-managers’ direct and positive contribution to firm performance, owner-managed firms can perform even better if diversity is part of the strategic choice. The positive relation of diversity and firm performance suggests that SME boards should move in this direction, but the results also indicate a deficit in either owner-managers’ understanding of the benefits of diversity or how this can be harnessed. Diversity in boards is more than a milestone along the firm growth pathway and goes beyond moral obligation. It should be seen as an opportunity to increase firm performance and, from a theoretical perspective, its relevance means that it should become more central to UE thinking and a formalised aspect.

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References


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Figure 1

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