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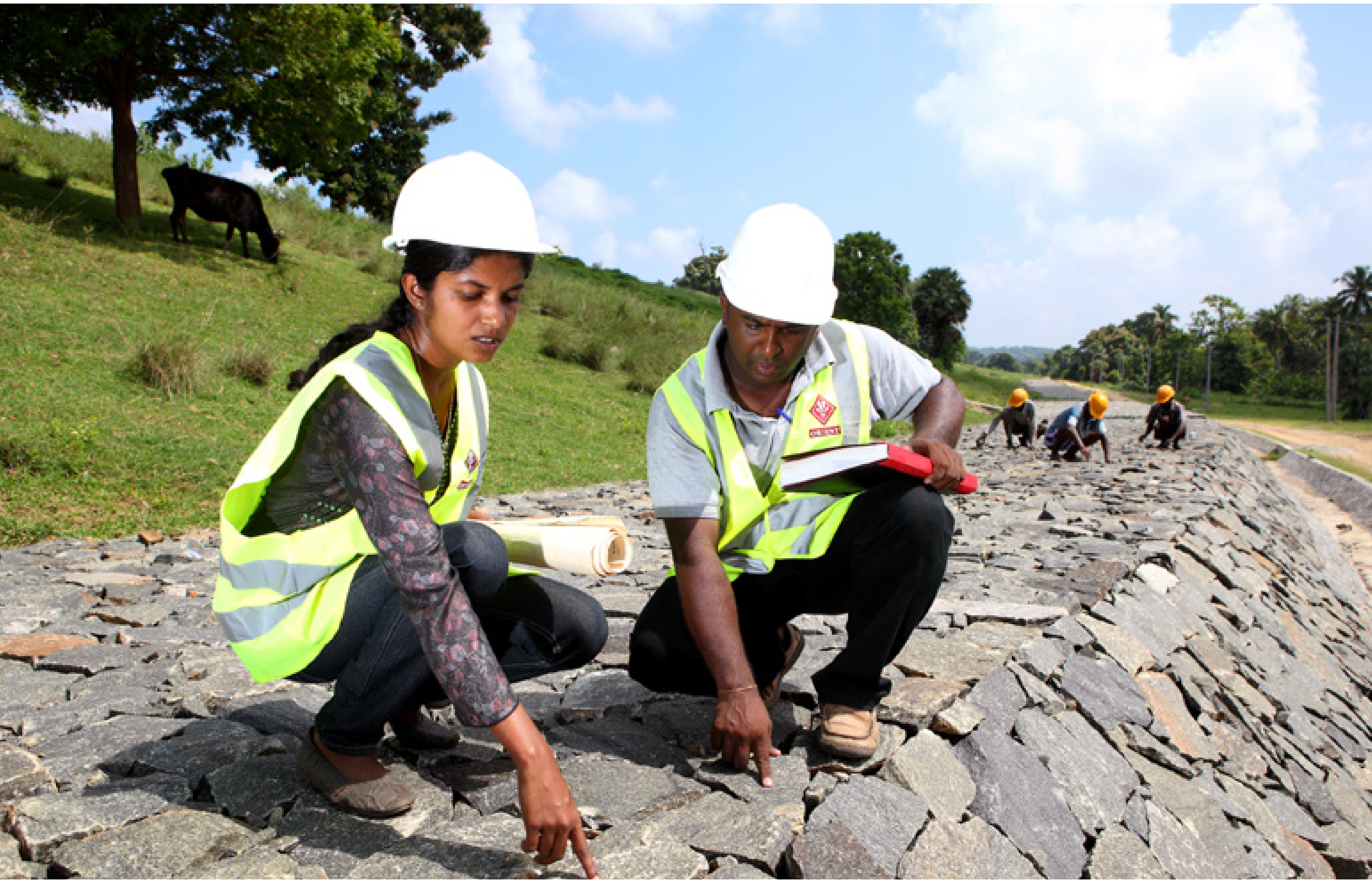

Does Gender Diversity Improve Firm Performance? Evidence from India

By Ruchika Joshi

December 2017

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Introduction

The relationship between gender diversity and firm performance has been the subject of research inquiry for over three decades now. However, if businesses were to turn to this body of literature for insights to drive their hiring practices, they would be hard-pressed to find conclusive evidence[1] on what to do. While some studies say that fostering gender diversity improves firm outcomes, others claim the opposite is true. Yet another set of studies find that there is no significant link between gender diversity and organizational performance. As a result, when it comes to fostering gender diversity as part of their workplace strategy, private sector firms are often left to rely on past experiences, stereotypes and anecdotal assertions. This is a problem.

With only about one in four women working or looking for work,[2] India faces a dilemma of rapid economic growth alongside lower economic participation of women.[3] While the productivity losses from squandering the productive potential of nearly half of India's workforce are clear,[4] there has not been enough focus on the opportunities and challenges women face in the workplace.

Despite recent attempts by the government to institute policies and practices toward fostering gender diversity in the workplace in hopes of encouraging more Indian women to join the workforce, many of them have fallen short in practice. This is partly because of the resistance from private sector actors, which lack rigorous evidence on how gender diversity shapes their outcomes. The workplace forms the backdrop against which diversity-enhancing policies are instituted, and firms wield sufficient power to shape their day-to-day implementation. Since firm actions and priorities are motivated by considerations of organizational performance, this paper examines the key question: How does gender diversity affect firm performance in India?

The workplace forms the backdrop against which diversity-enhancing policies are instituted, and firms wield sufficient power to shape their day-to-day implementation.

Existing literature is mostly limited to examining gender diversity in corporate boardrooms and senior management. But reaching these positions depend on the opportunities and resources that women are afforded early on in their careers. If women are missing from the traditional career pipeline, they will be absent in corporate boardrooms as well. Here, the research is lacking.

This paper analyzes secondary data for Indian firms based on the World Bank 2014 Enterprise Survey,[5] to evaluate the gender diversity-performance link at the organizational level. While there is no significant effect of gender diversity on firm performance overall, when disaggregated by sector, firms in the retail sector show positive impact of gender diversity on their performance.

Drawing from these results and highlighting the different channels through which diversity affects organizational performance, this paper argues against narrow definitions of both firm performance – as well as – gender diversity. Limitations of data availability have so far confined researchers to examining gender diversity as a matter of proportion of women and men within the corporate boardroom. But gender diversity is not a numbers game alone. Instead, it must be evaluated based on the opportunities women have access to and the challenges they have to navigate, across all ranks and at every stage of their professional advancement. The way in which gender diversity impacts firm outcomes depends considerably on the context within which this relationship is being examined, making it imperative to collect and analyze data, both quantitative and qualitative, that captures this complex reality, instead of only relying on an incomplete understanding of what gender diversity means.

Gender diversity is not a numbers game alone. Instead, it must be evaluated based on the opportunities women have access to and the challenges they have to navigate, across all ranks and at every stage of their professional advancement.

Against this backdrop the right question to ask is not whether gender diversity improves performance, but whether firms are fostering an inclusionary climate to leverage the benefits of gender diversity toward better firm performance. The policy recommendations at the end suggest how this can be achieved.

Declining Female Labor Force Participation and Scope for Private Sector Involvement

Globally, female labor force participation[i] (FLFP) rate remains significantly lower than its male counterpart. In 2016, only 50 percent of women in the labor force were working or looking for work, compared to 76 percent of men.[6] Moreover, according to the Global Gender Gap Report 2016, published by the World Economic Forum, in an alarming reversal of several years of progress, the gap between men and women in terms of economic participation and opportunity has been widening. In fact, at the current rate of change, it would take 170 more years[7] for women to achieve economic parity with men.

[i] *Labor force participation rate is the proportion of the population aged 15 and older that is economically active.*

In India, the situation is particularly dire. Despite economic growth, declining fertility rates and rising levels of education,[8] India's FLFP rate fell sharply from just over 37 per-cent in 2005 to 27 per-cent in 2016.[9]

Indian women continue to perform the bulk of unpaid work. When they are employed to do paid work, it is disproportionately in the informal sector where working conditions and wages are poor.[10] In the formal sector, women remain glaringly absent from leadership positions[11] and are paid considerably less than their male counterparts for the same job.[12]

Women's low workforce participation is not just bad for their individual economic empowerment but also has serious macroeconomic implications for the country. For instance, there is ample evidence[13] that if women participate in the labor market to the same extent as men, it will lead to significantly higher economic growth and productivity gains for the economy. In fact, according to one study, complete gender parity could add nearly $2.9 trillion to the country's annual gross domestic product (GDP) by 2025 – a massive 60 percent more[14] than if women's participation stays constant. This makes sense considering that presently the productive potential of nearly half the population is not being effectively harnessed.

The economic benefits of gender parity in the labor market do not rest on merely bringing more women into the workforce, but instead on bringing them into quality jobs.

Additionally, higher female labor force participation also helps expand[15] the available pool of skilled workforce and mitigate the talent shortage faced by Indian firms – a pertinent issue discussed in more detail later.

By providing quality employment to women, which in turn leads to better opportunities for them to earn income and exercise control over household spending, India can reap the benefits[ii] of broader economic development. Since employment is a critical channel through which the benefits of economic growth reach most population, some commentators have gone so far as to argue that in emerging economies, women's work may be the most crucial lever[16] for poverty reduction.

However, the economic benefits of gender parity in the labor market do not rest on merely bringing more women into the workforce, but instead on bringing them into quality jobs so that their productive potential can be harnessed toward a more sustainable growth trajectory. To facilitate this, governments across the world have introduced various policies that support women employees. These include improved family benefits, better access to comprehensive, affordable and high-quality child care, investment in rural infrastructure to reduce women's unpaid labor, greater expenditure on

[ii] *For instance, compared to men, women typically spend a greater proportion of household income on children's education. Therefore, by encouraging higher school enrolment for children, including girls, women's labor force participation and higher earnings can kick-start a virtuous cycle of women's education and economic empowerment feeding into each other. Source: IMF. 2013. Women, Work, and the Economy: Macroeconomic Gains from Gender Equity.*

educating and skilling women workers, enhanced access to finance, training and social networks for women entrepreneurs, and stringent legislation against gender discrimination in the workplace.

In several countries,[17] governments have also taken the affirmative action of reserving quotas for women directors in corporate boardrooms. The Indian government has taken similar steps from making it mandatory for listed companies to appoint at least one female director on their board[18] to recently increasing paid maternity leave from 12 to 26 weeks[19] – the third highest globally[20] after Canada (50 weeks) and Norway (44 weeks).

Yet many such policies often face implementation hurdles, stemming partly from the resistance offered by private firms. For instance, in India, reservations for women in corporate boardrooms initially led to the perverse outcome that many of the appointed women directors were token representatives with no real decision-making power. In one instance, it was reported[21] that a woman director was serving on the boards of as many as seven listed companies! In 2017– three years after the deadline for complying with the act had passed –women directors constituted only 13 percent of all representation in the boardrooms of the top 500 companies listed on the National Stock Exchange. If multiple directorships were to be excluded, this figure would fall further to only 10 percent. Moreover, only 60 percent of all women directors were reported to be truly independent.[22]

Similarly, when asked how their hiring approach would change with India's new maternity bill in place, over a quarter of respondents[23] from a sample of more than 4,300 entrepreneurs, start-ups, and small and medium enterprises, said they would now prefer to hire male employees since providing extended maternity leave and childcare facilities were expected to negatively impact their business and profitability.

Not only do firms often resist such policy changes, but in many cases they may even contribute to an adversarial labor market faced by women. Sexual harassment in the workplace continues to be a big problem[24] for women. In fact, while interviewing employees in BPO's, IT sector offices and various educational institutes, hospitals and legal firms across India, one survey found that about 38 percent women[25] had faced sexual harassment at workplace. Moreover, nearly two thirds of those surveyed admitted to the absence of provisions mandated by the 2013 Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act,[26] and indicated that it to be one of the main hurdles in registering a complaint.

Firms constitute the stage at which employees add value to production processes. They play a major role in effecting policies aimed at increasing female labor force participation and can significantly shape the challenges and opportunities women workers face in their day-to-day professional tasks and interactions with their colleagues. If private sector companies don't actively promote gender parity across sectors and job-roles, other efforts toward increasing women's economic participation are bound to fall short. However, firms will be motivated to

facilitate gender diversity in the workplace if doing so improves their performance outcomes in an increasingly competitive marketplace.

While the "business case for gender diversity" – i.e. the notion that diversity improves organizational processes and performance – is getting stronger,[27] and firms are already taking active measures[28] such as ensuring equal representation, providing mentoring and leadership training to women workers and instituting family-friendly employee policies to foster a more gender inclusive workforce, the empirical evidence on the issue tells a complex story and remains largely mixed.[29] Conclusions vary[30] from positive to negative to no effect of gender diversity on firm performance, and depend significantly on the quality of data available, type of methodology used and the context of evaluation. There remains a dearth of conclusive research on the issue, making it imperative to explore it in much greater detail and generate layered insights based on more nuanced understanding of gender diversity and firm performance.

This is particularly important for countries like India, where one significant long-run factor underlying declining FLFP is the occupational segregation of women[31] into specific industries and jobs. Regressive gender norms as well as adversarial labor markets riddled with problems of wage discrimination, poor working conditions and lack of adequate skills training for women, mean that women in India are disproportionately present in occupations that have not seen employment growth overall. Between 1994 and 2010, women took up less than 19 percent of the new employment opportunities generated in India's 10 fastest growing occupations which accounted for 90 percent of all employment growth.[32] This, in turn, has limited the number of job opportunities available to women and poses a barrier to their participation. In fact, in the same period, only 9 million women in India gained employment – a figure that could have nearly doubled[33] if women had equal access to the same industries and occupations as their male counterparts.

By fostering gender diversity at the firm level, providing equal access to good jobs, discouraging discriminatory employment practices and investing in creating ladders for women to rise in job ranks across sectors, we can curtail occupational segregation and unlock significant productivity gains and economic growth.

Clearly, there is an urgent need for reducing this occupational segregation, and the private sector is instrumental to this goal. By fostering gender diversity at the firm level, providing equal access to good jobs, discouraging discriminatory employment practices and investing in creating ladders for women to rise in job ranks across sectors, we can curtail occupational segregation and unlock significant productivity gains and economic growth.

Literature Review

While many important studies[34] have uncovered a positive association between gender diversity and firm performance, there is lack of empirically robust and consistent evidence of a causal relationship between the two. For example, investigating the link between gender diversity in senior management and financial performance of 2 million companies in Europe, authors of a recent study[35] documented a strong positive association between share of women in senior positions and corporate return on asset, but admitted that establishing empirical causality is difficult.

Broadly, the existing literature has sought to narrow down the ambit of research to examining the relationship between women in senior management and corporate boardrooms, and (i) firm financial performance and (ii) actions taken by the board.[36]

Arguing that gender diversity in the boardroom improves the monitoring role of the board and positively influences corporate governance, especially in countries that lack strong external oversight mechanisms, Campbell and Vera examined 4,050 Spanish firms to reveal a positive impact[37] of gender diversity on firm value. Numerous studies based on American firms highlight that gender diversity in top management positively affects firm performance,[38] and that certain corporate decisions pertaining to acquisitions and equity offering yield higher announcement returns, when they are taken by women rather than men.[39]

In India, Sarkar and Selarka analyzed more than 10,000 firms over a 10-year period to find that gender diversity in the boardroom has a positive impact[40] on both firm value and firm profitability. Examining the presence of independent women directors on the board, another recent study of large listed Indian companies also concluded that independent gender diverse boards positively influenced[41] the financial performance of firms.

On the other hand, studying 1,939 firms in the U.S., Adams and Ferreira found that although gender diversity in boardrooms is positively associated with firm outcomes such as greater participation of directors in decision-making and better alignment of shareholder interests through equity-based compensation, the average effect of gender diversity on firm performance is negative.[42] In Norway, where a ground-breaking law was passed in 2003 mandating 40 percent of all public-limited firms' directors be women, Ahern and Dittmar found that the constraint led to a significant fall in the stock price, less experienced board composition, increase in leverage and acquisitions and a decline in firm performance.[43]

Other studies have found no significant relationship between gender diversity and firm performance. For example, an analysis of 4,200 entrepreneurs across Sweden revealed that despite systematic differences between female- and male- headed firms, there was no significant evidence of female underperformance[44] on the firm's economic variables including sales and profitability. Another study of publicly listed Chinese firms failed to find any clear link between CEO gender and firm's return-on-asset or return-on-equity.[45]

In conclusion, the overall empirical evidence on whether gender-diversity in senior management leads to better firm performance is mixed.

Most existing research focuses on the impact that women in corporate boards have on firm outcomes, which creates a critical gap in the literature especially when one considers that for women to reach the boardroom, they need to be present throughout the pipeline, i.e. from entry-level to executive and management positions.

Most existing research focuses on the impact that women in corporate boards have on firm outcomes, which creates a critical gap in the literature especially when one considers that for women to reach the boardroom, they need to be present throughout the pipeline, i.e. from entry-level to executive and management positions.

Traditionally, the primary route to becoming a board director is through CEO-experience.[46] In 2011, 51 percent of all Fortune 500 directors had prior CEO experience.[47] In fact, with 97 percent of respondents considering professional experience to be "critical" and "important", a survey by the National Association of Corporate Directors concluded CEO-level experience to be the single most important functional background in recruiting a new director.[48] In 2015, 30 percent of all new independent directors in Fortune 500 companies were active or former senior executives.[49]

Since women presently constitute merely 6.4 percent of all Fortune 500 CEOs[50] and only a quarter of all executive and management positions,[51] it is easy to see that one key reason for why women are absent from corporate boards is their under-representation in the traditional pipeline to board service.[52] In fact, in 2016, one-third of all global businesses had no women in senior roles – a statistic that had remained unchanged since 2011.[53]

Even when women are promoted to senior managerial roles, they find their progress hindered by lack of experience in roles that revolve around revenue-generation or profit and loss responsibility.[54] Additionally, lack of mentoring relationships and networking opportunities prevent women from climbing up the corporate ladder.[55]

Addressing these issues requires alignment between organizational priorities, strategies and processes. Moreover, since gender diversity affects firm performance through several processes within workgroups, as explained earlier, it is important to examine how these dynamics play out at executive and mid-management levels as well, where the day-to-day functional decisions are taken and executed. While senior executives may set the broader corporate strategy, it is the middle management, department managers and salaried supervisors who are key to how these policies are implemented.[56] As a result, we need to go a step further to examine the impact of gender diversity at the organizational level.

Yet there is a serious dearth of research on impact of gender diversity on this front,[57] and the few studies that do examine the effect of firm-level gender diversity on performance don't paint a clear picture.

Evaluating performance as return on equity, McMillan-Capehart found it had a positive association[58] with organizational gender diversity. On the other hand, examining the relationship between store sales and gender diversity across 700 stores, one study concluded that the effect of gender diversity in the workplace was non-significant.[59] Although, this result might be because of the routine tasks performed by employees, which don't involve complex decision making, problem solving or information processing – all channels through which gender diversity positively affects workplace performance.

The mixed evidence on impact of gender diversity on firm performance can be explained by which channels of diversity-performance are activated,and the data, methodology and performance indicators being used.

To resolve the competing positive and negative predictions, some studies indicate that the relationship might in fact be non-linear. According to Frink et al. gender composition and firm performance have an inverted U-shaped relationship,[60] with the organization's profitability being highest when equal proportions of men and women were present in the workplace. Using employee productivity as a measure of firm performance, yet another study found partial support for both a positive linear gender diversity-performance relationship, along with evidence for an inverted U-shaped curvilinear association[61] which qualified and refined the linear prediction, to give more layered insight. The study reported that at low and moderate levels of gender diversity, the relationship between diversity and performance was positive, after which it levelled off and then became negative as gender diversity increased.

The mixed evidence on impact of gender diversity on firm performance can be explained by which channels of diversity-performance are activated,and the data, methodology and performance indicators being used. But the most critical aspect to this is an understanding of gender diversity that extends beyond the numerical representation of men and women in an organization, and examines the context within which this relationship is being examined.

Each of these aspects have been explained in the following sections.

Channels Through Which Gender Diversity Affects Firm Performance

The demography of a work-group critically influences group processes,[62] which affect group performance, which in turn shapes organization's performance.[63] Several theories underpin this link between organizational demography and performance. These can be narrowed down to three primary perspectives: information processing; similarity-attraction; and social categorization and identification theory. Depending on which channel is more activated, the effect of gender diversity on firm performance can be negative or positive.

The demography of a work-group critically influences group processes which affect group performance, which in turn shapes organization performance.

Information processing theory

One central view is that there is "value in diversity".[64] This optimistic view of diversity draws from the information-processing approach, according to which a diverse group encourages individuals to access other individuals with backgrounds, experiences, networks, information, education and expertise that are different from their own. By facilitating a positive environment of constructive disagreements, debates and discussions, diversity in work groups furthers novel insights, creativity and innovation, and advanced-problem solving geared toward higher-order outcomes – far better than what would be possible in more homogenous teams.[65] This is because when presented with conflicting opinions, knowledge, perspectives, a diverse group can consider, discuss and evaluate all relevant interpretations, alternatives and consequences, before narrowing down to a common resolution and making the relevant task-related decision. Interestingly, just the presence of diversity can also signal that a difference of opinions is likely and should be expected, in turn enabling a group to handle conflict and solve problems in a better manner.[66] Through this channel of information-processing, gender diversity can be a source of sustained competitive advantage[67] for the organization.

Amidst intense competition firm-level gender diversity allows businesses to serve their clients better.[68] By matching their firms' demographic composition to those of critical consumer groups, companies can leverage familiarity with niche markets to gain a competitive advantage. Considering that the "niche market" in question refers to nearly a billion women who would enter the global economy by 2020 for the very first time as employees, entrepreneurs and consumers,[69] it is critical for firms to have a gender diverse workforce if they are to tap into the spending power and economic potential of the "third billion".

Having more women on the team equips firms to understand their unique requirements and spending behaviour as consumers. For instance, one study[70] quoted a CEO who said, "*we are in the healthcare business, and most decisions about healthcare are made by women. So not having women on the board would be ridiculous. I don't think companies in the types of businesses where women make most of the spending decisions can get good input from their directors when they don't have women on the board. You get a much better sense of what's going on in the real world if you have the woman's viewpoint in the boardroom*".

Another example is that when voice recognition software in cars was first launched, it barely recognized women's voices because the original design team had low female representation and consequently female inputs, during the development stages. As a result, the software ended up calibrated to the voices and speech patterns of the male members of the design team, and when launched failed to serve female-end users[71] since their commands were not recognized by their cars.

But the case for gender diversity in teams extends beyond identity group representation. Increased gender diversity at team level also enhances the innovative capacity and performance of both individuals and teams, and consequently for firms.[72] Evidence corroborates[73] that companies with greater gender diversity generated more revenues from innovative products and services as compared to the rest. Analyzing a sample of 1,500 S&P firms, Dezsö and Ross showed that firms with female representation in senior management not only exhibited greater "innovation intensity", but also generated, on average, USD 40 million more in economic value[74] compared to firms which had no women in their top management teams.

Evidence corroborates that companies with greater gender diversity generated more revenues from innovative products and services as compared to the rest.

The importance of gender diversity to spur innovation is especially relevant today as businesses across sectors are struggling to cope with the disruptions[75] accompanying sweeping technological advancements. From automation to artificial intelligence, these transformations bring opportunities as well as challenges for businesses as they strive to stay competitive against new products, services or business models that are completely supplanting the existing versions.

Women managers are positively associated with such "disruptive innovation",[76] as they are more likely than men to exhibit key leadership behaviours,[77] such as investing in people development and matching professional expectations to suitable rewards. Despite being critical to the business needs of the future, these leadership qualities are in short supply today,[78] strengthening the case for firms to foster gender diversity and leverage it toward navigating a rapidly changing marketplace.

Similarity-attraction, and social categorization and identification theory

A more pessimistic view of diversity however, is that it creates social divisions which hinder social integration and cohesion, in turn leading to negative outcomes for the group.[79]

Two main theories support this view. According to the similarity attraction paradigm, individuals with similar attitudes, values and beliefs tend to exhibit greater interpersonal liking and affiliation toward each other.[80] But even without any prior social interaction with one another, individuals can display preferences for members from particular groups. According to the social categorization and the social identification theory,[81] individuals create a self-identity based on social categories such as race, gender, values or beliefs. This self-identity is closely linked to their self-esteem in social situations. As a result, to maintain a positive sense of self in comparison to other individuals with distinct social characteristics, they not only overemphasize their differences but also perceive these differences negatively, which hampers group processes such as communication and cohesion.[82]

When individuals categorize themselves and others in a hierarchical structure at the personal or group levels, there are differences in expectations for in-group and out-group members, leaving out-group members more prone to stereotyping than those within.[83] These stereotypes feed into "in-group" bias toward individuals belonging to similar social categories, and negatively affect group performance.

For instance, consider the problem of favoritism that stems from such an "in-group" bias, particularly in contexts where selection criteria is extremely subjective. Women are often excluded from informal networks of advice, sponsorship support and mentorship. As out-group members, women's achievements and competence are attributed to external factors of luck and special treatment, and are overshadowed by those of in-group male counterparts whose achievements are attributed to intrinsic strengths of intelligence, commitment and ambition. Despite having displayed objectively equal performance, women are held to higher standards and have to be better than their male counterparts to be considered for the same role.[84] As authors of one study[85] argue, "*women's competence has to be widely acknowledged in the public domain or through family connections before boards . . . will be prepared to 'risk' having a woman on the board*."

Therefore, if gender diversity produces negative behavior such as reduced communication,[86] stereotype-based role expectations,[87] a lack of cohesion[88] and cooperation,[89] and increased conflict[90] among employees, it can lead to low individual and group performance, which in turn may amount to diminished aggregate organizational performance.[91]

Considerations of Data, Methodology and Performance Indicators

The other key reason underlying the mixed empirical evidence is the lack of data. Typically, the available data is restricted to publicly listed companies and pertains narrowly to gender composition in the boardroom, which is a problem because the resulting sample size is too small to be meaningful.[92] Not only does this make it difficult to detect a statistically significant effect of gender diversity – especially if it is small in magnitude – but it also ignores the broader corporate sector where small- and medium- sized enterprises account for a considerable share of overall output and employment.[93] Additionally, there is a significant gap in data on gender composition by hierarchy within organizations.

Other methodological shortcomings such as short-term observations of performance measures, difficulty in controlling for reverse causation (i.e. effect of firm performance on gender diversity), measurement errors, endogeneity issues and omission of important variables that affect performance, also contribute to the varied empirical results. Mixed findings might also stem from the variation in time periods, countries, economic environments and type of firms under examination, as well as from varied performance indicators used across studies.[94]

There is a need to expand the notion of what constitutes improved firm performance and to carefully evaluate how gender diversity impacts firm outcomes as a whole.

Measuring performance outcomes in terms of return on assets, return on equity and stock prices, also fails to capture the true extent of impact of gender-diversity on firm performance. Workplace diversity dynamics are complex, and affect firm performance through many channels, the effects of which may not be captured in narrow measures of financial performance. There is a need to expand the notion of what constitutes improved firm performance and to carefully evaluate how gender diversity impacts firm outcomes as a whole. For example, in addition to direct measures of firm profitability, we need to examine how diversity affects other factors such as talent recruitment and retention, as well as corporate reputation, which in turn are linked to economic dividends. These effects are often complex to measure and may not be accurately assessed if the performance variables being examined are uni-dimensional.

Corporate reputation

Increased membership of female directors is positively associated with corporate reputation.[95] A survey of all Global Fortune 500 companies[96] found that well-reputed companies had twice as many women in senior management compared to those held in lesser regard. Another study[97] found that as the number of women directors on the corporate boards of the Fortune 500 companies increased, the probability of the companies to be ranked higher on corporate responsibility and ethical orientation increased, which in turn had clear economic benefits for the firms. For instance, a positive corporate reputation can improve the company's corporate branding which is instrumental for launching new products and tapping new markets,[98] along with increasing its financial performance, share price, and the institutional investment it attracts.[99]

The link between corporate reputation and gender diversity is of more relevance now than ever before. As the recent episodes of sexism in big companies like Google and Uber depict, a company's internal culture and workplace dynamics are no longer 'internal'.[100] With rapid advancements in how we consume and disseminate information, consumers can now see every aspect of how a business functions. As workgroup processes become a fundamental part of a company's brand, and consumers have more agency to reward or punish firms based on their internal culture, there is a pressing urgency for firms to increase gender diversity to stay competitive.

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Talent acquisition and retention

The other firm outcome that must be evaluated as part of performance is talent. In an increasingly diverse labor market, actively promoting gender diversity can help firms to attract and retain the best talent, which is critical for firms to perform well.

More than half of those employers facing the challenge of bridging the talent gap feel that they are not able to serve their clients satisfactorily, which decreases their competitiveness in the market.[101] To recruit the best people, an organisation must take advantage of the entire talent pool and tap into the potential of eligible women candidates. This is especially important if there exists a competitive talent shortage, as is the case for firms in India.[102]

With only 2 percent of India's labor force qualifying as formally skilled,[103] 58 percent of firms in India encounter difficulty finding qualified employees.[104] Moreover, estimating for the period between 2013 and 2022, the National Skill Development Corporation found the non-farm sector would require an additional 120 million skilled workers, in turn indicating that the shortage of workers is likely to remain a major concern for firms in India.

As the proportion of Indian women pursuing secondary and tertiary education increases,[105] it makes sound business sense for firms to foster gender diversity and draw in women candidates, who are more likely to prefer working for organisations that value gender diversity and are therefore more likely to invest in their professional growth and job-satisfaction. If firms limit their hiring to male candidates, despite the presence of eligible women candidates, the talent shortage would be more severe.

As the proportion of Indian women pursuing secondary and tertiary education increases, it makes sound business sense for firms to foster gender diversity and draw in women candidates.

Retaining the best talent is equally important, since employee turnover is expensive. It has been estimated that the cost to replace an employee can amount to half of their annual salary, while total turnover costs can range from 150 to 200 percent.[106] Actively affirming their commitment to diversity in the workplace can help firms decrease turnover,[107] since employees are inclined to stay on in firms where they are treated fairly and have access to the same opportunities as their colleagues.[108]

Importance of Context in Evaluating the Diversity – Performance Link

In addition to considerations of data, methodology and outcome indicators in understanding the diverse findings, it is equally important to note that the issue of gender diversity in the workplace has been reduced to a simple numbers game. But gender diversity goes much beyond the proportion of men and women in a firm, and must be understood as such. It matters when, where and how women participate in the workplace.

There is emerging evidence that the influence of women directors on corporate boards is considerably shaped by the broader context,[109] i.e. the situational settings within which professional working relationships and interactions occur. While theoretical perspectives of information processing, similarity-attraction, and social categorization and identification theory explain why gender diversity might manifest in specific work-group or organizational outcomes, a careful consideration of the context is important to understand when, where and how it happens. By determining the specific constraints as well as opportunities that shape team dynamics, situational settings can either reduce or amplify the direct impact of gender diversity on performance,[110] thus reconciling some mixed empirical evidence from past research.[111]

Three key contextual influences that affect the gender diversity-firm performance link are occupational demography, industry setting and climate for inclusion.

Occupational demography

When one demographic group dominates an occupational setting, negative stereotypes against underrepresented groups are exacerbated and distinguishing information about minority group members at an individual level is ignored. Status differences in the broader social context between the dominant demographic group and the minorities may also filter into team-level interactions, with overrepresented individuals being perceived as having greater expertise. This, in turn, hampers performance of individuals from the minority demographic group, negatively affects team interaction, and contributes to poor performance outcomes.[112]

Research evidence increasingly points towards the notion that for gender diversity to affect performance, a 'critical mass' of women must constitute the work group.

Joshi and Roh give the example of one such occupational category of production engineers. Given the broader context where majority of production engineers in the labor market are male, female engineers within a mixed team are prone to negative stereotyping such as possessing inferior technical competence. They also have lesser access to resources, which shapes their overall team performance unfavorably. The authors' meta-analysis of 8,757 teams, confirms that in a male-dominated occupational setting, gender diversity had more negative effects on performance outcomes compared to more gender-balanced settings, where these effects were weaker.[113]

Another example is when women are appointed as token members to symbolise diversity in the boardroom and in senior management. Studies confirm that token members often experience social isolation, greater scrutiny and marginalisation, which leads to poor outcomes.[114] Tokenism perpetuates gender stereotypes as women in a minority feel compelled to make themselves socially invisible by downplaying their distinct skills, attributes and perspectives so as to avoid disrupting perceived group harmony and alleviate any discomfort felt within the male-dominant group.[115] This, of course, hinders their performance and reinforces false notions that women don't bring anything new to the table.

Research evidence increasingly points towards the notion that for gender diversity to affect performance, a 'critical mass' of women must constitute the work group.

Examining a sample of 458 women directors on Norwegian boards, one study[116] concluded that women perceive that their influence on decision making processes of the board increases with the ratio of board membership held by women directors. Analysing the supervisory boards of 151 German stock exchange firms over a five year period, Joecks at al. report that at very low levels of gender diversity there are negative effects on firm performance. But this changes when the proportion of women reaches 30 percent, following which diverse teams demonstrate superior performance to more homogenous teams.[117] Similar results have been observed in organization-level analysis as well, but results on what proportion constitutes the optimal critical mass vary considerably.[118]

As Konrad et al.119 note, "While a lone woman can and often does make substantial contributions, and two women are generally more powerful than one, increasing the number of women to three or more enhances the likelihood that women's voices and ideas are heard and that boardroom dynamics change substantially…Suddenly having women in the room becomes a normal state of affairs."

As Konrad et al.[119] note, "*While a lone woman can and often does make substantial contributions, and two women are generally more powerful than one, increasing the number of women to three or more enhances the likelihood that women's voices and ideas are heard and that boardroom dynamics change substantially…Suddenly having women in the room becomes a normal state of affairs. No longer does any one woman represent the 'woman's point of view,' because the women express different views and often disagree with each other. Women start being treated as individuals with different personalities, styles, and interests. Women's tendencies to be more collaborative but also to be more active in asking questions and raising different issues start to become the boardroom norm*."

Industrial setting

In addition to occupational demography, another key contextual factor that moderates the relationship between gender diversity and performance is the industrial setting, which refers to the specific business environment in which the workgroups are embedded. These go beyond occupational settings to include contingencies of technological change, regulatory pressure, customer demands and market competition – factors that differ by industry and have significant bearing on organizational processes.

For instance, compared to the manufacturing industry, which relies more on physical capital and equipment, the service industry – which includes sectors such as education, retail trade and hospitality– is more customer-oriented. Close interaction and engagement with the customers creates more room for discretionary behaviour on the part of employees as part of operating teams, which has direct consequences for performance outcomes such as sales, customer satisfaction and customer retention.[120]

In fact, one way this context manifests in performance outcomes is how demographic diversity can give a competitive edge to a firm in the service industry market.[121] For example, the market insight advantage of gender diverse workgroups is more likely to improve the performance of firms in the retail sector where customer satisfaction and retention are more closely linked to employee diversity attributes. A retail firm which fosters gender diversity is more likely to attract women customers and increase sales, compared to a firm that fails to improve its employee diversity and market share. Similarly, high-technology industries that depend on invention and innovation to develop globally competitive short-cycle products are more likely to benefit more from the varied skills, knowledge, attitudes and networks that fostering employee diversity brings.[122]

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In comparison, firms in the manufacturing sector depend more on equipment, technology and raw materials to improve performance outcomes, and are more likely to implement HR practices that involve greater supervision of employee behavior. This may lead to diminishing the impact of diversity on organizational performance.[123] Moreover, along with having a lower degree of job interdependence,[124] separate workstreams in manufacturing industries means that there is little interaction between men and women making it difficult for organizations to leverage the benefits of collaboration toward higher order outcomes.[125]

Indeed, empirical evidence supports the argument for evaluating the effect of gender diversity on firm performance in context of industry setting. In their analysis which reveals that firm performance peaks in gender-balanced settings, Frink et al. find that this holds true in the service industry but not in manufacturing, thus suggesting that industries differ in their ability to benefit from fostering gender diversity.[126] Sampling Australian firms, Ali et al. also found evidence of moderating effects of industry type indicating that the positive impact of gender diversity is stronger for firms in the services industry and the negative impact of gender diversity is stronger for firms in the manufacturing industry.[127]

My analysis of Indian firms also showed that while the effect of gender diversity on employee productivity and total output of the firm was statistically insignificant overall, the effect of gender diversity on employee productivity was statistically significant and positive in enterprises operating in the retail sector. While the retail sector is relatively a low productivity sector overall,gender-diverse firms[iii] in the retail sector have higher labor productivity as compared to more demographically homogenous retail firms.

Climate for inclusion

Another critical factor for harnessing the productive potential of women employees is creating an enabling climate of inclusion for them. To leverage the true potential of gender diversity in firm performance, employers need to go beyond the short term goals of token representation, plurality and diversity management, to focus instead on creating an environment of inclusion.

It must be noted that while valuing differences and introducing diversity training and management to prevent sexual harassment and discrimination and promoting mentoring, skills training, and family-friendly policies, are crucial, they do not automatically lead to inclusion and empowerment of minority employees.

To leverage the true potential of gender diversity in firm performance, employers need to go beyond the short term goals of token representation, plurality and diversity management, to focus instead on creating an environment of inclusion.

As Sabharwal[128] explains in her study, "*employees making use of work/life balance programs or alternative work arrangements report backlash and are often singled out as receiving preferential treatment. These programs will not be successful as long as they are viewed as "accommodations" that benefit one group more than the others. Employees taking advantage of such policies are deemed to work in less desirable jobs. Single mothers taking advantage of alternative work arrangements are labeled to be on the "mommy track," are taken less seriously, and are often passed over for promotions (Saltzstein, Ting, & Saltzstein, 2001). Very few men use such policies for fear of career derailment or of being labeled as "uncommitted" . Such perceptions are strengthened by unsupportive organizational culture in which supervisors do more to create an exclusionary, rather than an inclusionary, work environment*."

The positive channel of information-processing mentioned previously – through which gender diversity improves performance – will not automatically result from having more women in the workplace. Instead, this channel needs to be enabled by an inclusionary environment. To integrate and utilize a diverse workforce toward achieving organizational goals, firms need to encourage minority employees to freely express themselves, as well as to deliberately include them to bear on the organization's decision making processes. There is a need to create an environment where employees feel valued and recognized for their work, have a higher sense of self-esteem and feel comfortable to express their ideas and opinions safely. Achieving this requires effective commitment from top leadership and empowering all employees with the right resources to deliver high performance.[129]

There is growing evidence to support the importance of a climate for inclusion in evaluating the diversity-performance link. Examining data from a survey of public managers in the state of Texas in the U.S., one study found that inclusive organizational behaviours that foster commitment from top leaders and involve employees in decision-making processes positively impact organizational performance.[130] Another study reported that climate for inclusivity moderates the link between gender-diversity and workgroup dynamics, so that lower levels of conflict are experience by gender-diverse groups.[131]

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Against this backdrop, it is clear that gender diversity is not just about ensuring fair representation of men and women in teams. There is a pressing need to include the context in which the diversity-performance link is being examined. This has important implications for resolving the mixed results observed in previous studies. It is not enough to ask whether gender diversity improves performance. We need to address further whether firms are fostering the right climate of inclusion to leverage gender diversity towards better firm performance. Examining the broader situational settings allows us to do just that.

Policy Recommendations

To address the persistent challenges, the following framework must be effected:

1. Creating a supportive labor market for women in collaboration with the private sector

The need for better policies that draw women into the workforce is greater than ever. But the government should actively engage the private sector in designing the policies since the private sector is a key stakeholder who can significantly shape the extent to which these policies are successfully implemented.

Policymakers should also strengthen the current focus on skilling female workers, so that they are not stuck in low-productivity jobs and can increase their contribution in mixed groups.

At the same time, they need to address the demand side of the labor market as well. There is no point skilling workers for jobs that don't exist. Countries like South Africa and Spain have

[iii] In the current analysis, only firms with a female to male employee ratio between 0.7 to 1.3 are considered to be gender diverse. See appendix for the detailed methodology and results.

pioneered youth wage subsidies.[132] India could pilot the world's first wage subsidy policy for women – where the state pays a portion of the salary earned by entry-level female workers. Another example would be offering tax rebates to companies that achieve gender diversity targets – among all permanent employees and in positions of leadership.

Promoting gender-sensitive infrastructure must also be a top priority. This means setting up hostels, crèches, public toilets and safe public transport for women workers of all ages and occupations, or subsidizing private firms which do so.

2. Fostering a climate of inclusion in the workplace throughout women's career trajectories

Firms, especially those in the service sector and geared toward innovation, should strive to create an inclusionary climate where women employees can freely express their differences and have access to equal resources. In addition to diversity management practices, firms can improve their performance by instituting leadership dedicated to fostering inclusion and empowering women employees to shape decision making processes, across all ranks in the organization and not just for women in senior management.

It is important that women are afforded equal opportunities in their careers early on, so they can climb the corporate ladder as fast as their male colleagues and the gender gap can be closed before it widens. Firms should have formal programs and measurable targets to foster such an inclusionary environment that benefits all employees equally, enables high performance from everyone and effectively checks any diversity backlash.

3. Expanding the evidence base on gender diversity across all levels in the organization

There is a serious dearth of data that captures the context in which diverse teams work. In fact, one key constraint limiting previous studies to measuring only the proportion of men and women in boardrooms and senior management is the lack of data on women in mid- and entry-level positions, as well as on the indicators pertaining to diversity management and inclusion.

Despite increasing agreement on the value of diversity, very few businesses have programs or processes to formally measure their own progress in improving firm-level gender diversity. This needs to change. Firms should monitor and evaluate metrics that track women's progress from entry to leadership, as well as capture contextual factors, to determine why, where and when outstanding talent drops out of the race for leadership positions, and then bridge the gaps that are identified.

Finally, there is a need to explore further what management practices constitute a successful diversity inclusion program and how they can be integrated as part of organizational processes.

Appendix

Empirical methodology and results

The main objective of this study is to analyze the effect of gender diversity on firm performance. Gender diversity relates to the gender composition of a firm. A firm with perfect gender diversity is one which has an equal proportion of men and women. However, allowing for random variation around the even gender ratio, companies with an uneven gender ratio may still qualify for gender diversity if the imbalance is not significant.

In the current analysis, only firms with a female to male employee ratio between 0.7 to 1.3 are considered to be gender diverse, i.e. in a company with a total of 100 employees, if female employees are more than 41 and less than 57, then the company is designated as a gender-diverse enterprise.

The lower limit of 0.7 and the upper limit of 1.3 have been selected for two reasons. First, this helps separate the effect of balanced workforce since the limits are not far away from equal distribution, and allow for random variations around the even gender ratio. Second, under these limits, the dataset provides a significant number of gender-diverse firms, thereby reducing the chance factor during the estimation. Although the number of gender-diverse firms under examination would have increased if a wider interval had been selected, doing so would have also diluted the concept of gender diversity. However, since there remains an element of subjectivity in setting these limits, scholars' opinions may differ on what the appropriate range should be.

Firm performance, on the other hand, is measured by average employee productivity which is calculated by dividing total sales value by the number of employees. Economic literature shows that one of the important factors that affects productivity is capital stock. Capital stock also accounts for technology in a company. In this study, capital stock is controlled for by including fixed capital in the empirical model.

Data for the present study is from the World Bank's Enterprise Surveys for the year 2014. It provides information on female and male employment for 2,112 enterprises distributed across eleven industrial sectors in India. Of these, only 190 firms are gender diverse as per the chosen definition.

To capture the effect of gender diversity on firm performance, this study uses the dummy variable technique, which helps investigate whether the performance – measured here as labor productivity – of gender-diverse firms is significantly different from those lacking gender diversity, after controlling for other important factors affecting the dependent variable. The dummy variable is 1 for gender-diverse firms (i.e. firms where female to male ratio is between 0.7 and 1.3) and 0 for firms without gender diversity (i.e. firms where female to male ratio below 0.7 or more than 1.3).

In addition to exploring whether there is a significant differential effect of having a gender-balanced workforce on productivity, this study also investigates whether differential effects exist across industrial sectors. In other words, this study attempts to examine whether the effect of gender diversity on firm performance varies by industry setting. To do that, it separately estimates a dummy variable interaction model, where the gender-diversity dummy variable interacts with the industry dummy variables.

Formally, the basic form of the empirical model that we estimate is as follows:

$$Y_i = \alpha_0 + \alpha_1 Genderdiversity_i + \alpha_2 D_i + \alpha_3 Genderdiversity_i{*}D_i + x_i\beta + \varepsilon_i (i \in 1,2...,n)$$

where Y_i is the log of employee productivity in firm i. This is calculated by dividing total sales value by total number of employees. Genderdiversity is a dummy variable taking value 1 for firms with a balanced workforce, and zero otherwise. D_i is industry dummy. $x_i\beta$ is a 1xk vector of control variables, expressed in log form. Finally, ε_i is the error term. The coefficients α_1 and α_2 capture the differential effect of gender diversity on productivity, and industrial differential intercepts, respectively. Whereas, the coefficient on the interaction term (α_3) captures the effect of gender diversity on employee productivity in a particular industry.

The effect of gender diversity on output per worker is statistically significant and positive in enterprises operating in the retail sector.

Several robustness checks are performed, such as the use of robust standard errors, which overcomes issues arising from heteroscedasticity [iv] and autocorrelation. In another robustness check, the dependent variable is measured differently.

It may further be noted that of the 11 industries under examination, interaction effects were introduced for only five industries due to lack of sufficient number of gender diverse firms in the remaining six industries. The signs and statistical significance of the control variables used in the model are consistent with economic theory, indicative of correct specification of the econometric model.

This study finds that as the share of female to male employee increases, average employee productivity falls. The total value of output in firms with relatively higher share of female workers is lower than in firms with higher share of male employees. But these effect of gender diversity on both total output and employee productivity is statistically insignificant.

In the retail sector, of a total 328 firms there are only 18 firms where gender diversity exists as per the given definition. The effect of gender diversity on output per worker is statistically significant and positive in enterprises operating in this sector. In terms of responsiveness, a one percent increase in gender diversity in retail sector raises

[iv] *Bertrand, M., E. Dufflo, and S. Mullainathan. 2004. "How much Should We Trust Difference in Differences Estimates?" Quarterly Journal of Economics CXIS: 249–275.*

Table 1

Effect of Gender Diversity on Total Output

Independent Variables	With robust standard errors Dependent variable: logarithms of total output	
Constants	7.364*** (0.020)	5.124*** (0.251)
Gender Diversity	0.029 (0.063)	-0.060 (0.062)
Technology	---	0.151*** (0.048)
Number of workers	---	0.910*** (0.040)
R-square	0.0001	0.578
No. of observations	1946	611

Note: (a) figures in parenthesis represent robust standard errors (b) *=p<0.10, **=p<0.05, and ***=p<0.01.

Table 2

Effect of Gender Diversity on Average Employee Productivity

Independent Variables	With robust standard errors Dependent variable: logarithms of output	
Constants	5.876*** (0.013)	5.080*** (0.250)
Gender Diversity	-0.082** (0.037)	-0.068 (0.062)
Technology	---	0.133*** (0.0422)
Number of workers	---	0.910*** (0.040)
R-square	0.001	0.056
No. of observations	1946	611

Note: (a) figures in parenthesis represent robust standard errors (b) *=p<0.10, **=p<0.05, and ***=p<0.01.

the overall output per worker by 0.34 percent. These results suggest that gender-diverse firms in the retail sector have higher labor productivity as compared to more demographically homogenous retail firms.

Table 3

Effect of Gender Diversity on Productivity and on Employee Productivity in Retail

Productivity (Log)	Coefficients	Robust Standard Error	t	P > |t|	[95% Confidence Interval]	
Capital (log)	.1211893	.0436564	2.78	0.006	.0354532	.2069255
Gender Diversity	-.1078196	.0682026	-1.58	0.114	-.2417618	.0261225
Retail	-.1777133	.0678882	-2.62	0.009	-.311038	-.0443887
Gender Diversity in Retail	.3410722	.1650677	2.07	0.039	.0168979	.6652464
Constant	5.172824	.2635952	19.62	0.000	4.655153	5.690495

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