Firms benefit when board directors have different nationalities

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Despite the increasing prevalence of diversity on corporate boards, there is still not much clarity on a firm's motives to recruit directors from diverse nationality backgrounds. This is particularly important as a large number of UK- and US-based listed firms regularly employ foreign nationality directors on their boards. We know from the literature that significant variations exist between national-level variables such as living standards, values and happiness. This implies that national differences can be attributed to a variety of sources, including socio-economic conditions, culture and even aggregate personality.

Take first how national differences can arise due to differences in socio-economic conditions. The economics and finance literature often compares countries based on different social or economic indicators such as income, employment, or human capital for per capita GNI (Gross National Income). For any one of these indicators one can find similarities among a group of countries but the differences among them can also be striking. Business and management studies have therefore been more interested in finding the impact of national differences on work-related attitudes.

For example, national differences in cultural values significantly determine individual nations' work and risk-related attitudes (see the work of Geert Hofstede). Another line of inquiry is how national differences may arise due to differences in national personalities. These works indicate that nationality can be a valuable source of knowledge about institutions, behaviours and norms. For example, knowing how different nationality people might behave in a given situation might create a better understanding of cultural variations and how these variations impact upon firm decisions. This knowledge may also provide essential resources to the firm such as expertise and ties to external networks and resources.

Foreign nationals may also possess an ability to understand better the needs and aspirations of a diverse body of stakeholders and the markets in which a firm does its business. In a recent study, we exploit the tendency of the UK firms to get foreign nationals on their boards to shed light on the nature and scope of diversity on corporate boards. We ask whether diverse nationality boards affect firm governance in some meaningful way, and whether there are any measurable benefits available to the companies that employ directors from other nationalities. Our findings show that foreign nationality directors actively provide their inputs, resulting in increased levels of board activity as reflected in attendance behavior, committee assignments and corporate governance. We also find a positive and significant association between nationality diversity and firm performance.

Our results provide further support to the idea that firms choose directors for their characteristics. There are a number of factors that contribute to this heterogeneity. For example, firms may choose directors as a means of dealing with events in the external environment. Director characteristics may also affect their incentives to monitor managers. They may also have certain attributes that enable them to facilitate firm operations such as merger and acquisitions. The differences in human and social capital among directors of different races and genders may influence the firm's decision-making process.

When widening the diversity of their boards, firms may also consider appointing foreign nationality directors on their boards. As we find, national variations influence a director's monitoring and resource provision functions. Different national backgrounds create incentives for the directors to achieve higher standards of performance in discharging their board functions. Consequently, diversity increases a firm's ability to respond to the expectations of diverse interest groups. It also enables the firm to acquire timely data on environmental changes, and helps undertake crucial control functions.

Directors with a diverse national background are also likely to promote product or geographic diversification, motivated as they are to meet the needs of a diverse set of stakeholders. For example, a director with varied interests and associations may be able to create linkages with different investor, supplier and consumer groups. Moreover, in a world awash with increasing national and international interdependencies, board directors' identities are likely to be a crucial indicator of how a firm makes sense of its complex environment. This can be seen in how foreign nationality directors may seek to expand the company's operations toward those areas that reflect their own interests and knowledge and expertise.

Such an influence may also determine how other board directors might perform their monitoring and resource provision functions as well and add value. As we find, firms that seek to introduce diversity into their boards experience improved performance, although firms may also take such actions in response to regulation or other similar motivating factor. Diversity may lead to the perception that another person is different from oneself, but it may still generate positive firm value.

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Notes:

- *This post is based on the authors' paper* [Diverse boards: Why do firms get foreign nationals on their boards?](), *in the Journal of Corporate Finance, February 2016.*
- *This post gives the views of its authors, not the position of LSE Business Review or that of the London School of Economics.*
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