

OPEN ACCESS

# African Journal of **Business Management**



October 2020  
ISSN: 1993-8233  
DOI: 10.5897/AJBM  
[www.academicjournals.org](http://www.academicjournals.org)

 **ACADEMIC  
JOURNALS**  
expand your knowledge

# About AJBM

The African Journal of Business Management (AJBM) is a peer reviewed open access journal. The journal commenced publication in February 2007 as a monthly publication. The scope of the journal covers all areas of business and management research. The journal welcomes submission of full-length research articles, short communications and review articles. In addition, the journal also welcomes letters and commentaries to the editor. Please see Instruction for Authors for complete details. The journal is currently published monthly. Please see journal archive for all past issues or see all published articles

## Indexing

[CNKI Scholar](#), [Economics and Business Studies Database](#), [Google Scholar](#), [IBZ Online Database](#), [Microsoft Academic](#), [ResearchGate](#)

## Open Access Policy

Open Access is a publication model that enables the dissemination of research articles to the global community without any form of restriction. All articles published under open access can be accessed by anyone with internet connection.

The African Journal of Business Management is an Open Access journal. Abstracts and full texts of all articles published in this journal are freely accessible to everyone immediately after publication without any form of restriction.

## Article License

All articles published by the African Journal of Business Management are licensed under the Creative Commons Attribution 4.0 International License. This permits anyone to copy, redistribute, remix, transmit and adapt the work provided the original work and source is appropriately cited. Citation should include the article's DOI. The article license is displayed both on the abstract page and the full-text PDF of each article.

This article is published under the terms of the [Creative Commons Attribution License 4.0](#)

Please refer to <https://creativecommons.org/licenses/by/4.0/legalcode> for details about [Creative Commons Attribution License 4.0](#)

### **Article Copyright**

When an article is published in the journal, the author(s) of the article retain the copyright. Author(s) may republish the article as part of a book or other materials.

A copyright statement is displayed both on the abstract page and the full-text PDF of each article.

Example: Copyright ©2016 Author(s) retains the copyright of this article.

Please see SHERPA/RoMEO

### **Self-Archiving Policy**

In addition, the journal permits and encourages authors to archive the published version of their articles on their institutional repositories and as well as other appropriate websites.

Please see Portico, SHERPA/RoMEO and The Keepers Registry

### **Digital Archiving Policy**

The African Journal of Business Management is committed to the long-term preservation of its content. All articles published by the journal are preserved by Portico.

### **Metadata Harvesting**

The African Journal of Business Management encourages metadata harvesting of all its content. The journal fully supports the Open Archives Initiative.

## Memberships and Standards



Academic Journals strongly supports the Open Access initiative. Abstracts and full texts of all articles published by Academic Journals are freely accessible to everyone immediately after publication.



All articles published by Academic Journals are licensed under the [Creative Commons Attribution 4.0 International License \(CC BY 4.0\)](#). This permits anyone to copy, redistribute, remix, transmit and adapt the work provided the original work and source is appropriately cited.



[Crossref](#) is an association of scholarly publishers that developed Digital Object Identification (DOI) system for the unique identification published materials. Academic Journals is a member of Crossref and uses the DOI system. All articles published by Academic Journals are issued DOI.

[Similarity Check](#) powered by iThenticate is an initiative started by CrossRef to help its members actively engage in efforts to prevent scholarly and professional plagiarism. Academic Journals is a member of Similarity Check.

[CrossRef Cited-by](#) Linking (formerly Forward Linking) is a service that allows you to discover how your publications are being cited and to incorporate that information into your online publication platform. Academic Journals is a member of [CrossRef Cited-by](#).



Academic Journals is a member of the [International Digital Publishing Forum \(IDPF\)](#). The IDPF is the global trade and standards organization dedicated to the development and promotion of electronic publishing and content consumption.

## Contact

Editorial Office: [ajbm@academicjournals.org](mailto:ajbm@academicjournals.org)

Help Desk: [helpdesk@academicjournals.org](mailto:helpdesk@academicjournals.org)

Website: <http://www.academicjournals.org/journal/AJBM>

Submit manuscript online <http://ms.academicjournals.org>

Academic Journals  
73023 Victoria Island, Lagos, Nigeria  
ICEA Building, 17th Floor,  
Kenyatta Avenue, Nairobi, Kenya.

## Editors

### **Prof. João J. M. Ferreira**

*Department of Management and Economics  
University of Beira Interior (UBI),  
6200-209 Covilhã,  
Portugal.*

### **Dr. Amran Awang**

*Faculty of Business Management,  
02600 Arau, Perlis,  
Malaysia.*

### **Dr. Nebojsa Pavlovic**

*Faculty of Hotel and Tourism  
University of Kragujevac,  
Kragujevac  
Serbia.*

## Editorial Board Members

### **Dr. Elisa Menicucci**

*Department of Business Studies  
University of Roma Tre,  
Italy.*

### **Dr. Werbin Eliana Mariela**

*Department of Accounting  
National University of Cordoba,  
Argentina.*

### **Dr. Aktham AlMaghaireh**

*United Arab Emirates University  
Department of Economics & Finance  
United Arab Emirates.*

### **Prof. Simone Poli**

*Department of Management,  
Università Politecnica delle Marche,  
Italy.*

### **Dr. Haretsebe Manwa**

*Tourism Department  
Faculty of Human and Social Sciences  
North West University  
Private Bag X 2046  
Mmabatho 2735,  
South Africa.*

### **Dr. Reza Gharoie Ahangar**

*Islamic Azad University of Babol,  
Iran.*

### **Dr. Sérgio Dominique Ferreira**

*Polytechnic Institute of Cavado and Ave  
Campus IPCA, Lugar does Aldão, 4750-810.  
Vila Frescainha,  
Portugal.*

### **Prof. Ravinder Rena**

*Department of Economics  
University of the Western Cape  
Private Bag: X17 Modderdam Road  
Bellville 7535 Cape town,  
South Africa*

### **Dr. Shun-Chung Lee**

*Taiwan Institute of Economic Research  
No. 16-8, Dehuei Street, Jhongshan District,  
Taipei City 104,  
Taiwan.*

### **Dr. Gregory J. Davids**

*University of the Western Cape  
Private Bag x17, Bellville 7535,  
South Africa.*

### **Dr. Maurice Oscar Dassah**

*School of Management, IT and Governance  
University of KwaZulu-Natal  
Post Office Box X54001  
Durban 4000  
South Africa.*

### **Prof. Joseph Offiong Udoayang**

*University of Calabar  
P.M.B 1115, Calabar. Cross River State,  
Nigeria.*

### **Prof. Robert Taylor**

*University of KwaZulu-Natal  
Varsity Drive, Westville  
South Africa.*

### **Dr. Izah Mohd Tahir**

*Universiti Sultan Zainal Abidin  
Gong Badak Campus,  
21300 Kuala Terengganu,  
Malaysia.*

**Dr. V. Mahalakshmi**

*Panimalar Engineering College  
7-A, CID Quarters, Mandaveli, Chennai-600028,  
Tamilnadu,  
India*

**Dr. Ata Allah Taleizadeh**

*Iran University of Science and Technology  
Faculty of Industrial Engineering,  
Iran University of Science and Technology,  
Narmak, Tehran,  
Iran.*

**Dr. José M. Merigó**

*University of Barcelona  
Department of Business Administration, Av.  
Diagonal 690,  
Spain.*

**Dr. Anton Sorin Gabriel**

*Carol I Boulevard, No. 11, 700506, Iasi,  
Alexandru Ioan Cuza University Iasi,  
Romania.*

**Dr. Aura Emanuela Domil**

*31 Horia Creanga, zip code 300253, Timisoara  
West University from Timisoara  
Faculty of Economics and Business  
Administration,  
Romania.*

**Dr. Guowei Hua**

*NO. 3 Shangyuancun, Haidian District,  
Beijing 100044,  
School of Economics and Management,  
Beijing Jiaotong University,  
China.*

**Dr. Mehdi Toloo**

*Technical University of Ostrava  
Ostrava,  
Czech Republic.*

**Dr. Surendar Singh**

*Department of Management Studies,  
Invertis University  
Invertis village, Bareilly -  
Lucknow Highway, N.H.-24, Bareilly  
(U.P.) 243 123,  
India.*

**Dr. Colin J. Butler**

*University of Greenwich  
Business School, University of Greenwich,  
Greenwich, SE10 9LS, London,  
UK.*

**Dr. Colin J. Butler**

*University of Greenwich  
Business School, University of Greenwich,  
Greenwich, SE10 9LS, London,  
UK.*

**Prof. Dev Tewari**

*School of Economics and Finance  
Westville Campus University of Kwa-Zulu  
Natal (UKZN) Durban, 4001,  
South Africa.*

**Dr. Paloma Bernal Turnes**

*Universidad Rey Juan Carlos  
Dpto. Economía de la Empresa  
Pº de los Artilleros s/n  
Edif. Departamental, Desp. 2101  
28032 Madrid,  
España.*

**Dr. Jurandir Peinado**

*Universidade Positivo  
Rua Silveira Peixoto, 306  
Zip 80240-120 Curitiba – PR –  
Brazil.*

**Dr. Abdelaziz Hakimi**

*Management,  
Faculty of Law, Economics and Management of  
Jendouba,  
Tunisia.*

**Dr. Henrique Reis**

*Economics and Management,  
Higher School of Management - IPS,  
Portugal.*

**Dr. Obed Ligate**

*Independent researcher,  
University of North America (Alumni),  
United States.*

**Dr. Roberto Bruni**

*Department of Economics and Law,  
University of Cassino and Southern Lazio,  
Italy.*

**Dr. Svetlana Saksonova**

*Faculty of Management and Economics,  
University of Latvia,  
Latvia.*

**Dr. Gaetano Matonti**

*Faculty of Management and Economics,  
University of Latvia,  
Latvia.*

# Table of Content

<b>How empathy, social contracts and deep conversations are helping companies in Kenya overcome the disruptive impact of the COVID-19 pandemic</b> Allan D. M. Bukusi	309
<b>Sovereign debt crisis and capital structure decisions of firms in GIPSI countries</b> Oscar Domenichelli	313
<b>Does gender diversity matter for risk-taking? Evidence from Italian financial institutions</b> Elisa Menicucci and Guido Paolucci	324
<b>Social responsibility practices of leading firms in an industry: Driver for corporate citizenship in Kenya</b> Fredrick Onyango Ogola	335
<b>The rules of business transformation</b> Allan D. M. Bukusi	447

*Full Length Research Paper*

# How empathy, social contracts and deep conversations are helping companies in Kenya overcome the disruptive impact of the COVID-19 pandemic

Allan D. M. Bukusi

Africa Leadership and Social Development Centre, Kenya.

Received 27 July, 2020; Accepted 4 September, 2020

The impact of the COVID-19 pandemic has disrupted market trading activity around the world. The pandemic has disabled supply chains and forced businesses to look for pragmatic ways to keep their doors open. Companies have suspended business commitments citing the *force majeure* clause. The resulting tension in companies is a hotbed for rising confusion and turmoil. With businesses facing imminent closure and potentially acrimonious court cases, pragmatic businesses have called for round table talks with stakeholders to resolve the crisis. This review suggests that the sensitive uses of conflict management and negotiation skills are crucial to obtaining shared responsibility agreements. Empathy, gently invoking a social contract and deep conversations are helping companies successfully navigate a path through this unprecedented season.

**Key words:** Conflict, conversations, social contract, Covid-19, force majeure, new normal, share-share outcomes, 21<sup>st</sup> Century leadership.

## INTRODUCTION

On March 11<sup>th</sup> 2020, the World Health Organization declared a global pandemic following the outbreak of the COVID-19 flu in Wuhan China (World Health Organization, 2020). Following this announcement, governments around the world scrambled to put in place self-preservation measures. These included international travel bans, suspension of trade and the implementation of social distancing programs (Kenya Government, 2020). Businesses around the world sent staff to work from their homes, cut salaries and dropped production targets. Companies pleaded for tax exemptions and suspended trade commitments in the wake of the

pandemic (Craven et al., 2020). The World Bank has signalled that the impact of the COVID-19 pandemic could trigger Africa's first economic recession in 25 years (World Bank, 2020). Major banks have restructured Ks176 Billion in client loans and allowed companies to come up with revised repayment projections (Juma, 2020). A major drop in employee incomes has caused a sudden change in consumer tastes and lowered purchases of market goods (Kenya National Bureau of Statistics, 2020). The COVID-19 pandemic has precipitated a business crisis that has disoriented management and left stakeholders wondering how to

Email: [allanbukusi@gmail.com](mailto:allanbukusi@gmail.com). Tel: +254715201535.

Author(s) agree that this article remain permanently open access under the terms of the [Creative Commons Attribution License 4.0 International License](https://creativecommons.org/licenses/by/4.0/)

restore a sense of order and normalcy in the market. Nonetheless, history suggests that the effects of the pandemic could last for several years (US Government, Centers for Disease Control, 2020). While the *force majeure* clause has allowed escape from immediate litigation for failed service delivery, it has only bought time for companies to reorganize their business in the short term (Rochefort et al., 2020). Companies still have to resolve the important questions of business continuity, medium-term staff relations and long-term strategic business focus.

## MATERIALS AND METHODS

In this exploratory article the author surveyed newspaper reports, official government statements and media publications on the business impact of COVID-19 between March and June 2020. During this period various media outlets kept the public informed on the measures taken by local and international companies to scale down, scale back and reorganize business operations. Published surveys also reported on the varied impact of curfews and restricted movement on the production and distribution of goods. Media reports revealed that major businesses have quickly established a negotiating framework to address emerging conflict over stakeholder interests. However, the study also found that while stakeholders struggled to create order out of a chaotic environment, they also seem to have embraced an unusual chord of humanity, if not a conciliatory business tone in the light of the global catastrophe.

### The problem

The unique nature of trade and social conflict caused by the pandemic has raised three major problems for business leaders; (a) How to resolve emerging conflict around stakeholder interests and concerns, (b) How to continue operations under *force majeure* conditions to advance stalled business operations, and (c) How to conduct negotiations with stakeholders to share the risks of proposals to keep businesses open.

## FINDINGS

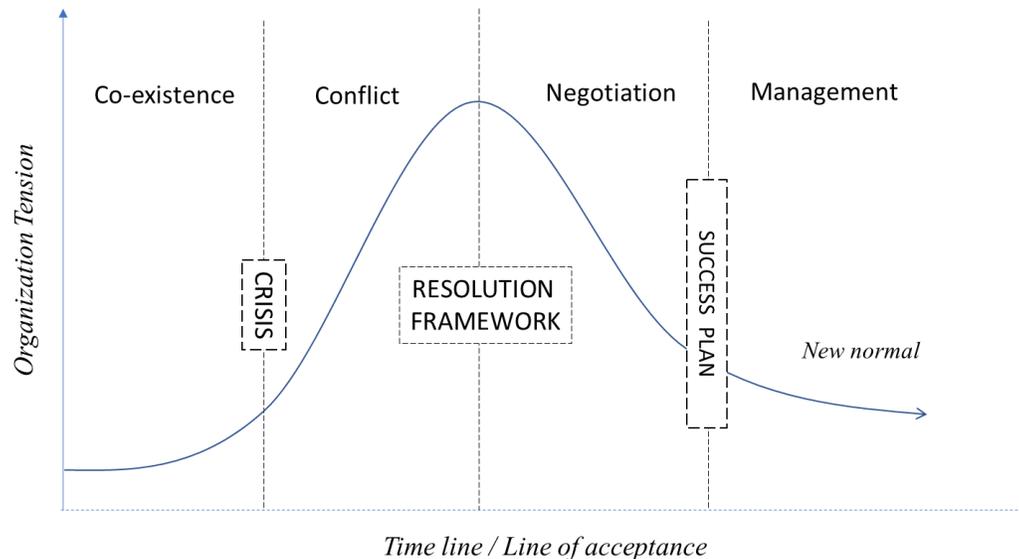
In order to quickly resolve looming operational losses and secure lifelines to a business future, business leaders have reverted to conflict and negotiation theory to help them resolve the current crisis (PWC Global, 2020). Conflict can be described as a difference in opinion, position or perspective on a matter affecting two or more parties. In the face of the COVID-19 pandemic, companies have had to negotiate with stakeholders to eliminate the possibility of total loss. While consensus on the broad issues was quickly reached, companies needed to agree with individual stakeholders on how specific interests and concerns were to be addressed (Deutsch et al., 2011). Framing these issues as a conflict allows all parties to acknowledge the need to deal with the emerging reality. Conflict management theory helps all parties work through the four phases of resolution (Figure 1) before the matter becomes acrimonious.

Looking back to the pre-crisis phase of co-existence enables stakeholders to review the positive and productive aspects of their relationship. It helps stakeholders resolve that the current crisis may affect interests and individual returns, but should not unduly derail their working relationship into the future. The second phase allows stakeholders to rationally examine the conflict elements brought about by the crisis and identify issues that need resolution. The third phase provides for the pragmatic negotiation of a resolution frame to bring down organization tensions (Lewicki et al., 2016). This stage addresses stakeholders' uncertainty and anxiety about their interests. The fourth phase allows the business to move into the new normal with managed expectations and a success plan to control the impact of the crisis. The four phases of conflict resolution enable a business and its stakeholders to develop an acceptable business recovery plan (Sheiner and Yilla, 2020).

An effective resolution frame works to contain untoward emotions, anger, and frustration and brings down heightened organization tensions (Davies, 2016). The process of conflict management includes crucial conversations, negotiations, arbitration or other processes to contain unacceptable differences (Patterson et al., 2002). The second phase allows stakeholders to come face to face with "force majeure" and helps all parties appreciate that the nature of conversation is hardly business as usual. Stakeholders acknowledge that business continuity is a matter of agreement rather than a search for legal options. In these moments of crisis contenders and competitors have pulled down defences to negotiate their mutual survival (Laskar, 2013). Stakeholders are re-learning how to do business at the speed of trust and rely on a social contract to keep their pledge as far as is humanly possible (Covey and Merrill, 2006). The "new normal" is unlikely to return stakeholders to pre-crisis business conditions. However, the crisis resolution process has become part of a surviving business success kit and equipped these businesses to navigate the prevailing disruptive business environment (Faeste and Hemerling, 2016).

## DISCUSSION

These negotiations have required that companies develop deeper skills in empathy, negotiation, conversation and collaboration with stakeholders (Lewicki et al., 2016). This kind of deep conversations would not have been considered practical in the normal cut-throat, competitive business environment where the strong survive and the winner takes all (Fischer and Ury, 1991). Companies are learning to cooperate and collaborate as success keys to a business future. Organizations have had to rethink and develop more inclusive business strategy. The pandemic has forced the business community to be more reflective by engaging colleagues



**Figure 1.** Conflict resolution graphic.

and associates in deep conversations guided by five important considerations. 1) Both parties stand to lose greatly in the event that an agreement is not reached, 2) Winning an argument or trying to get the upper hand in a discussion may not result in substantive business advantage to any party, 3) Losing or giving up an argument does not open up options further afield, 4) Surviving a crisis demands humility and a considerably dispassionate approach to openly address the reality at hand, and 5) Overcoming crisis calls for substantive emotional intelligence among leadership teams (Stone et al., 1999).

The COVID-19 pandemic is teaching companies to mix empathy with pragmatic business negotiation to develop collaborative survival strategies with all their stakeholders (Goleman, 2017). In the past, stakeholder concerns were taken care of separately and independently before being presented at a contested forum. Trade unions contended for employee benefits against what management had to offer, stakeholders pleaded for a business hearing, while strategy remained an exclusive boardroom affair (Howell and Sorour, 2016). The pandemic has opened up a new space where deep conversations have several benefits. First, these empathetic discussions create a safe space and communicate to all parties that “we are in this together” (Malunga, 2009). Second, they harness a business’s emotional energies to look for constructive options out of the crisis. Third, deep conversations conducted in good faith raise the levels of collaboration amongst stakeholders to share roles, risks and success of the enterprise. Fourth, the resulting collaborative strategy harnesses the strengths, capacity and competencies of each stakeholder, while compensating

for the vulnerabilities among them. Nonetheless, the pandemic has also highlighted a need for new, more empathetic, leadership theory in the 21<sup>st</sup> Century business environment (Montuori and Fahim, 2010).

## Conclusion

The COVID-19 pandemic has opened up new negotiation space giving stakeholders and industry players an opportunity for freer sharing of information, inter-business understanding and structuring mutually beneficial share-share agreements. The new normal environment has also introduced a heightened level of engagement between businesses and stakeholders. Empathy, social contracts and deep conversations call for open, non-judgemental communication and trust among market players. The share-share outcomes of these business conversations have allowed businesses to remain open in the short term and manage stakeholder expectations. Share-share outcomes have also helped businesses to model more inclusive medium-term business plans and design sustainable long-term business strategy.

## CONFLICT OF INTERESTS

The authors have not declared any conflict of interests.

## REFERENCES

Covey SM, Merrill RR (2006). *The speed of trust: The one thing that changes everything*. New York, Free Press.

- Craven M, Liu L, Mysore M, Wilson M (2020). COVID-19: Implications for business. McKinsey and Company.
- Davies W (2016). Overcoming anger and irritability: A self-help guide using cognitive behavioural techniques. Hachette UK.
- Deutsch M, Coleman PT, Marcus EC (2011). The handbook of conflict resolution: Theory and practice. John Wiley and Sons.
- Faeste L, Hemerling J (2016). Transformation: Delivering and sustaining breakthrough performance. Boston, MA: Boston Consulting Group.
- Fischer R, Ury W (1991). Getting to Yes. New York: Penguin Books.
- Goleman D (2017). Leadership that gets results (Harvard business review classics). Harvard Business Press.
- Howell KE, Sorour MK (2016). Corporate Governance in Africa: Assessing Implementation and Ethical Perspectives. Springer.
- Juma V (2020). Kenya's biggest banks restructure Sh176bn loans on coronavirus. Available at: <https://www.businessdailyafrica.com/corporate/companies/Kenya-s-biggest-banks-restructure-Sh176bn-loans/4003102-5545764-is96uu/index.html>
- Kenya Government (2020). Ministry of Foreign Affairs. Retrieved from National Emergency Response Committee on Coronavirus. Available at: <http://www.mfa.go.ke/?p=3303>
- Kenya National Bureau of Statistics (KNBS) (2020, May 15). Survey on Socio Economic Impact of COVID-19 on Households Report. Retrieved from Kenya National Bureau of Statistics. Available at: <http://www.knbs.or.ke/>
- Laskar ME (2013). Summary of Social Contract Theory by Hobbes, Locke and Rousseau. Available at: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2410525](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2410525)
- Lewicki RJ, Barry B, Saunders DM (2016). Essentials of Negotiation. New York: McGraw Hill.
- Malunga C (2009). Understanding Organizational Leadership through Ubuntu. London: Adonis and Abbey Publisher Ltd.
- Montuori A, Fahim U (2010). Transformative Leadership. ReVSION. pp. 1-3. Available at: [https://silo.tips/queue/a-journal-of-consciousness-and-transformation-alfonso-montuori-urusa-fahim?&queue\\_id=-1&v=1600937615&u=MTk3LjlxMC4yMDluMTYy](https://silo.tips/queue/a-journal-of-consciousness-and-transformation-alfonso-montuori-urusa-fahim?&queue_id=-1&v=1600937615&u=MTk3LjlxMC4yMDluMTYy)
- Patterson K, Grenny J, McMillan R (2002). AI Switzler. Crucial Conversations: Tools for Talking When Stakes Are High. New York: McGraw Hill.
- PWC Global. (2020). Six Key areas of Focus for Organisations. Available at: <https://www.pwc.com/gx/en/issues/crisis-solutions/covid-19.html>
- Rochefort LP, Boland MK, McRoskey RE (2020). The Coronavirus and Force Majeure Clauses in Contracts. Available at: <https://www.akerman.com/en/perspectives/the-coronavirus-and-force-majeure-clauses-in-contracts.html>
- Sheiner L, Yilla K (2020). The ABCs of the post-COVID economic recovery. Available at: <https://www.brookings.edu/blog/up-front/2020/05/04/the-abcs-of-the-post-covid-economic-recovery/>
- Stone D, Patton B, Heen S (1999). Difficult Conversations. London: Penguin Books.
- US Government, Centres for Disease Control (2020). Past Pandemics. Retrieved from CDC: Centres for Disease Control and Prevention. Available at: <https://www.cdc.gov/flu/pandemic-resources/basics/past-pandemics.html>
- World Bank (2020). World Bank predicts Recession for Africa. Retrieved from World Bank: <https://www.worldbank.org/en/news/press-release/2020/04/09/covid-19-coronavirus-drives-sub-saharan-africa-toward-first-recession-in-25-years>
- World Health Organization (2020). WHO Director-General's Opening Remarks at the Media Briefing on COVID-19 - 11 March 2020. Available at: <https://www.who.int/dg/speeches/detail/who-director-general-s-opening-remarks-at-the-media-briefing-on-covid-19---11-march-2020>

*Full Length Research Paper*

# **Sovereign debt crisis and capital structure decisions of firms in GIPSI countries**

**Oscar Domenichelli**

Department of Management, Faculty of Economics “Giorgio Fuà”, Università Politecnica delle Marche, Italy.

Received 24 July, 2020; Accepted 4 September, 2020

**This quantitative study examines the reasons for changes in the leverage levels of the firms in GIPSI countries (Greece, Ireland, Portugal, Spain, and Italy), following the development of the sovereign debt crisis that began in 2009. This research belongs to the empirical literature studying the effects on firm leverage of reduced bank credit supply caused by that crisis. For all the sample firms and for each firm typology, that is, unlisted, listed, unlisted family, unlisted nonfamily, listed family and listed nonfamily, and for the entire period being analysed, the sample means of the debt-to-assets ratio in each year were calculated. The results show that owing to the lack of bank credit, unlisted firms reduced their leverage, whereas listed companies generally maintained their indebtedness, thanks to their access to financial markets. In spite of their orientation to socio-emotional wealth and its protection, unlisted family firms could not decrease their debt-to-assets ratio significantly less than unlisted nonfamily firms, due to the restriction of capital offered by banks. In contrast, the inclination toward the consolidation of socio-emotional wealth possibly enabled listed family firms to take advantage of the scarcity in bank capital to increase their leverage via bond issues, while listed nonfamily firms reduced the proportion of debt they employed, as the perpetuation of the business for future generations is not an issue for them.**

**Key words:** Sovereign debt, capital structure, socio-emotional wealth, family and nonfamily firms, listed and unlisted firms.

## **INTRODUCTION**

GIPSI countries (Greece, Ireland, Portugal, Spain, and Italy) are generally characterized by bank-oriented financial systems (Bijlsma and Zwart, 2013). This implies that unexpected and sudden events weakening bank credit availability, such as the recent sovereign debt crisis in the euro zone of the European Union, have a sizeable impact on the capital structure of firms in GIPSI countries. Specifically, the sovereign debt crisis, which started in late 2009 in Greece and propagated throughout the euro zone among GIPSI countries, caused the interest rates of

the bonds of the sovereign debt of these states to increase and thus provoked the deterioration of the equity value of the banks that invested in those bonds. Consequently, banks' access to collateralized lending decreased, because the value of eligible collateral dropped, typically in sovereign bonds, and the available offer on interbank markets became weaker (Bofondi et al., 2013). Furthermore, raising capital from depositors became difficult for banks, as the perceived risk by investors considerably increased. Hence, this problem of

Email: [o.domenichelli@staff.univpm.it](mailto:o.domenichelli@staff.univpm.it). Tel: +390712207193.

Author(s) agree that this article remain permanently open access under the terms of the [Creative Commons Attribution License 4.0 International License](https://creativecommons.org/licenses/by/4.0/)

cash affecting banks, which had already been hit by the consequences of the subprime crisis exploded in 2007 and 2008 (Cingano et al., 2016) passed on to trade and manufacturing firms within the GIPSI countries, in the context of the extended slow development of the euro zone generally and of the GIPSI states in particular (Shambaugh, 2012). The general deterioration of the financial situation of the considered firms generated a sizable amount of non-performing loans and a further weakening of banks' ability to provide cash for businesses, in a complicated vicious circle involving GIPSI states and their financial and real economy.

Some researchers opine that the reduction in bank lending depended on the restriction in the offer and the increase in the cost of bank financing (Acharya et al., 2018; Corbisiero and Faccia, 2020; Demirgüç-Kunt et al., 2020), while others believe it was caused by a decline in the demand for credit by firms because of poor and scarce business opportunities (Jiménez et al., 2012; Bofondi et al., 2013). Both supply and demand reasons play a role in the reduction of bank lending and, regardless of the strength of these explanations, different kinds of firms are likely to react differently to the declining credit availability (supply), in terms of changes in their capital structure. This depends on their ability to substitute bank credit for lending from other sources, such as bond issues on financial markets, and their attitude toward debt as opposed to equity.

Hence, the focus of this study is the analysis and explanation of the possible capital structure variations of the firms in GIPSI countries, whereas the aim of this research is to empirically examine if, why, and how firms from GIPSI countries and of different characteristics changed their capital structure composition, owing to the reduction in bank supply as a consequence of the sovereign debt crisis. The objective of this analysis is to provide a contribution to the understanding of the consequences in terms of capital structure changes of the firms being investigated. This work uses a quantitative approach based on the interpretation of available data gathered from a large dataset of several thousand GIPSI businesses. The value of the research lies in the fact that it increases the knowledge and awareness of the real effects of the sovereign debt crisis in the euro zone, as expressed by the change in the leverage (measured by the debt-to-assets ratio) of the non-financial firms in GIPSI countries. The research problem being investigated concerns how companies with specific characteristics respond to credit availability, depending on whether they can issue bonds in financial markets (listed vs. unlisted firms) and their higher or lower orientation toward debt sources (family vs. nonfamily firms).

The rest of this paper is organized as follows. Firstly, the main dimensions of the sovereign debt crisis and their linkage with other euro zone crisis are discussed. Secondly, an explanation of the distinctive features of

family businesses, which may determine a greater orientation toward debt relative to their nonfamily counterparts, is offered. Thirdly, a few hypotheses of the impact of the sovereign debt crisis on the capital structure of the sampled firms are put forward. Then, the research method and results are given. Lastly, conclusions are presented.

### **The sovereign debt crisis and its linkage with other euro zone crises**

The impact of the sovereign debt crisis on the capital structure of affected firms can be fully and correctly interpreted if the sovereign debt crisis in the specific financial and economic context in which it exploded is analyzed. Specifically, three major crises occurred in the euro zone after the subprime crisis of 2007 and 2008 (Cingano et al., 2016). First, a banking crisis occurred, as banks were undercapitalized and encountered liquidity problems. Then a crisis arose categorized precisely as a sovereign debt crisis because a few states, that is, the GIPSI countries, faced rising bond yields and found it difficult to acquire financing. Lastly, there was a growth crisis, with both a low overall level of growth in the euro zone and an unequal distribution across countries (Shambaugh, 2012).

The subprime crisis generated a banking crisis owing to the collapse in the value of house prices and mortgages in the US (Fender and Gyntleberg, 2008). Moreover, despite the several securitization procedures of these risky assets, banks had financed the special purpose vehicles involved or they were sponsors of the operations and thus needed to avoid the bankruptcy of the special purpose vehicles to safeguard their reputation by financially supporting them (Monti, 2009). The banking crisis provoked a reduction in the liquidity of the international interbank markets, leading to credit restrictions (Gaiotti, 2013) in several countries. That significantly prevented firms from obtaining cash for investments and repayment of their outstanding debts, successively causing banks to increase the perceived level of risk of their borrowers and enterprises to increase the estimated degree of risk within transactions. The related deterioration of the business expectations and value creation provoked a fall in tax revenues, whereas public spending grew to help the real economy cope with the negative effects of the general crisis.

The banking crisis in particular worsened the public finance indicators (specifically debt-to-GDP and deficit-to-GDP ratios) of some countries within the so-called euro zone of the European Union, that is, Greece and the other GIPSI countries, which already had a weak public finance situation. In fact, following the collapse of Lehman Brothers in September 2008, most governments in the euro zone adopted banking-sector rescue packages of extraordinary impact. Furthermore, banking crises implied

further substantial losses of tax revenue (Gerlach et al., 2010). Additionally, as previously mentioned, there was a general crisis that generated a decrease in tax revenues and an increase in public spending in an attempt among governments to sustain enterprises and families. All of this entailed a further increase in the public deficit and debt relative to the GDP of the GIPSI countries and hence a significant growth of the spread of their bonds compared to that of the German bonds.

From an historical point of view, the sovereign debt crisis that originated in the euro zone in late 2009 became manifest from the first part of 2010, when it hit the GIPSI countries. In spring 2010, Greece was the first to exhibit difficulty with placing its public bonds on the market, owing to its very poor public finance situation. During the following months, other GIPSI countries, that is Ireland (November 2010), Portugal (April 2011), Spain, and Italy (July 2011), underwent the effects of a high increase in investors' requests for returns on public bonds (Busetti and Cova, 2013).

Moreover, the considerable public debt and low-growth prospects of countries such as Italy were also responsible for the high increase in the spread during the last part of 2011 (Busetti and Cova, 2013). Specifically, the euro zone was characterized by two dimensions of growth crisis. On the one side, the area on the whole developed too little to reduce the unemployment rate and support the debt level, and on the other side, the GIPSI countries grew considerably more slowly (Shambaugh, 2012).

In sum, the sovereign debt crisis took place in a situation of banking and growth crisis in the GIPSI countries, and this contributed to the poor availability of financing from banks, as explained in a subsequent paragraph. Past researches concerning financial crises and credit reduction to firms (credit crunch) have investigated their relationships. For example, Soana et al. (2013) observe that three main interpretations can be put forward in the context of the subprime mortgage crisis. In fact, the reduction in credit can depend on the restriction of the supply of bank financing (Albertazzi and Marchetti, 2010; Puri et al., 2011; Jemenéz et al., 2012; Iyer et al., 2014); on the contrary, a contraction in the demand for credit by firms can occur (Kremp and Sevestre, 2012; Rottmann and Wollmershauser, 2013); finally, some claim that the credit crunch should be viewed as the product of a simultaneous reduction in both credit supply and credit demand (Popov and Udell, 2010; Presbitero et al., 2012). Similarly, and more recently other authors examined the impact of the credit crunch, during the European sovereign debt crisis, on the corporate policies of GIPSI firms and also find mixed results. However, these studies cover very specific sources of bank financing for considerable firm investments, that is syndicated loans (Acharya et al., 2018), focus on SMEs to analyse their ability of obtain bank credit (Corbisiero and Faccia, 2020), compare firms with different

dimensions, without dealing with their family nature or not (Demirgüç-Kunt et al., 2020), concentrate on a specific GIPSI country (Jiménez et al., 2012; Bofondi et al., 2013).

Hence, to the best of the researcher's knowledge, no prior study covers the specific topic investigated. The issue examined concerns the capital structure decisions of firms in all the GIPSI countries, as a consequence of the sovereign debt crisis and thus bank credit rationing. In doing so, the study considers the various sources of financial debt and distinguishes not only between listed and unlisted firms, but also between family and nonfamily firms. A large amount of data was used to infer the likely reasons for the changes in indebtedness of the enterprises considered. Thus, this study helps clarify the effects of the sovereign debt crisis on the capital structure decisions of firms in GIPSI countries.

### **Family firms, socio-emotional wealth, and indebtedness**

Numerous explanations have been given to justify the level of indebtedness of a firm. In this respect, after the publication of the irrelevance theory by Modigliani and Miller (1958), researchers have identified taxation and distress costs (Kraus and Litzenberger, 1973), asymmetric information between insiders and outsiders (Myers, 1984; Myers and Majluf, 1984), and agency problems (Ross, 1973; Jensen and Meckling, 1976; Myers, 1977; Smith and Warner, 1979; Jensen, 1986; Mork et al., 1988) as significant determinants of the capital structure choices of businesses (Harris and Raviv, 1991; Rajan and Zingales, 1995; Frank and Goyal, 2009; La Porta et al., 1999; among others).

Several studies demonstrate that family firms would rather choose debt over equity when they finance their investments, whereas few show a negative effect of family ownership on the employment of debt financing (Michiels and Molly, 2017). However, this preference for debt financing is not likely to be associated with the specific role of the aforementioned main determinants of the capital structure in the context of family firms and, in particular, regarding substantial agency conflicts in family firms. The motivation is that family enterprises are characterized by a specific ownership and governance and they also need to create and maintain their socio-emotional wealth (SEW). It is worth emphasizing that SEW is defined as a group of several factors, including identity, the ability to exercise family influence, and the perpetuation of a family dynasty (Gomez-Mejia et al., 2007). SEW generation and safeguard require autonomy and control, family cohesiveness, supportiveness, harmony, loyalty, pride, family name recognition, respect, status, goodwill in the community (Zellweger et al., 2011), the need to transfer the family business to future generations, and the need to sustain the family's image and reputation (Naldi et al., 2013).

As just stated, ownership and governance features and SEW recognition imply that all types of agency conflicts are negligible in family firms and thus debt employment is not connected to the effect of or control on agency costs in family businesses. This assertion can be clarified as follows.

First, agency conflicts between managers and owners (Berle and Means, 1932; Jensen and Meckling, 1976; Jensen, 1986) are irrelevant in first-generation family businesses, as ownership and management are usually concentrated on the founder and his/her nuclear family (Blanco-Mazagatos et al., 2007). Besides, family owners usually have large ownership structures (Cheng, 2014), hence they have a strong incentive to effectively monitor managers (Demsetz and Lehn, 1985; Shleifer and Vishny, 1986; Villalonga et al., 2015), when they are not (rarely) managers themselves. In addition, owing to the SEW orientation; a family dominant group is more likely to engage in proactive stakeholder engagement activities, even when they offer no obvious financial returns. From this point of view, family managers are closely identified with the firm's actions and tend to live in the community (Gómez-Mejía et al., 2011). The virtual absence of the previously mentioned type of agency costs in first-generation family firms protects them from their use of debt being influenced by agency conflicts between owners and managers in these firms, neither by possible opportunistic managers nor as a means of control over managers by careful owners. Moreover, agency conflicts between managers and owners are also insignificant in later-generation family businesses, despite the fact that ownership and management become more dispersed and differentiated, and hence owner-managers can be focused on the interests of their family branch and make decisions for the benefit of their own nuclear family, rather than for that of the family (firm) as a whole (Blanco-Mazagatos et al., 2016). This is connected to the presence of appropriate governance mechanisms, such as direct control by non-manager owners, existence of board of directors and family governance mechanisms (for example, the family council mentioned by Villalonga et al., 2015), efficaciously disciplining managers, with no need for debt employment.

Secondly, agency conflicts between family controlling and non-controlling owners are also trivial. The very often considerable ownership by the family in family businesses and their related long investment horizon and great reputation concerns (Gedajlovic and Carney, 2010; Steijvers and Niskanen, 2014) lessen the agency conflicts between dominant family owners and minority owners in family firms. Hence, debt employment does not have a correlation with this kind of agency problem.

Thirdly, the agency conflicts between owners and lenders are looked at, they appear to be of minor importance, as is the scarce use of debt in reducing them, thanks to the SEW dimension, in terms of business perpetuation and family's image and reputation, for which

family owners tend to behave very fairly toward lenders. At the same time, though, because of their SEW orientation, family firms strive to maintain control over their business in the long run, which actually represents an important dimension of family socio-emotional wealth (Gottardo and Moisello, 2014) and dominate risk considerations (Gottardo and Moisello, 2014; Burgstaller and Wagner, 2015). In turn, this need for control over the business among present and future generations can lead family firms to pursue different capital structure decisions in the context of the sovereign debt crisis, as opposed to their nonfamily counterparts, that is to prefer a higher level of indebtedness. This issue constitutes a core topic of this work and thus will be further discussed in the next section, in which specific hypotheses are offered.

### **The sovereign debt crisis and its impact on the capital structure of the firms of GIPSI countries**

Following the eruption of the sovereign debt crisis, bank lending to non-financial corporations located in the GIPSI countries strongly decreased (Corbisiero and Faccia, 2020). Finance literature has investigated the underlying causes of the reduction in bank credit, producing two main interpretations.

According to some, the decline in bank lending essentially depended on the restriction in the conditions and supply of bank financing. First, banks' exposure to sovereign debt and the related value decrease of their equity, as well as the change in the banks' portfolios from corporate lending toward risky sovereign debt (through the moral suasion channel and risk-shifting channel) (Acharya et al., 2018), reduced the availability of bank financing for firms. In fact, on the one hand, less sound banks became riskier and found it difficult to raise new capital from depositors, corporate bond issues, or other banks (at least at affordable rates of interest) to provide to businesses. On the other hand, the increasing proportion of banks' liquidity employed in sovereign debt deteriorated the availability of bank credit for firms. Secondly, the further weakness in the bank balance sheet, caused by considerable non-performing loans, implied a lower ability to grant lending even to healthy firms (Corbisiero and Faccia, 2020). Lastly, during a financial crisis, the general weakening of the creditworthiness of firms means greater risk for lenders, so the term premium at which they are willing to lend increases significantly (Demirgüç-Kunt et al., 2020), and that generates a decrease in the actual access to bank loans for businesses.

According to others, however, this represents a contraction in the demand for credit by firms, owing to a lack of new business opportunities that caused the amount of bank loans to diminish (Jiménez et al., 2012; Bofondi et al., 2013). In other words, the worsening of the business forecasts in the context of a general crisis and

slow growth mostly in GIPSI countries (Shambaugh, 2012) pushed enterprises to postpone or give up new loan applications. The study neither disentangles demand and supply factors nor discuss their role and importance in terms of credit contraction among GIPSI countries, even if, both explanations may account for the decrease in bank lending. On the contrary, the study will provide a feasible explanation of the differences in capital structure decisions among firms of different types in GIPSI countries over the sovereign debt crisis. In fact, the possible change in the leverage of the firms belonging to these countries likely depends on their characteristics, since the latter are important determinants of a firm's capital structure choices (Jensen and Meckling, 1976; Jensen, 1986; Myers, 1977; Myers, 1984; Myers and Majluf, 1984; Harris and Raviv, 1991; Rajan and Zingales, 1995; Frank and Goyal, 2009).

Specifically, listed firms have access to financial markets and thus can compensate for a decrease in bank lending. In other words, capital markets provide a "spare tire" in time of financial crisis for listed companies (Demirgüç-Kunt et al., 2020). On the contrary, unlisted firms strongly depend on bank credit, especially in bank-oriented financial systems such as those in the GIPSI area (Bijlsma and Zwart, 2013) and thus are more likely to be affected by the worsening in the availability of bank loans (Shambaugh, 2012). Therefore, unlisted firms may have needed to reduce their leverage owing to more difficult access to bank lending, whereas generally listed firms may have not significantly changed their capital structure mix. Following this reasoning, the hypothesis is as follows:

H<sub>1</sub>: Unlisted firms reduced their leverage, whereas listed firms did not significantly decrease their leverage.

As far as family firms are concerned, several studies show that family firms prefer debt over equity when they finance their investments, whereas few show a negative effect of family ownership on the employment of debt financing (Michiels and Molly, 2017). This is due to SEW considerations, as argued in the previous section and, in particular, to the need to maintain control over the business in the long run (Burgstaller and Wagner, 2015) by avoiding the use of (external) equity. However, because of limitations in bank credit over the sovereign debt crisis, unlisted family firms could have been unable to reduce their leverage significantly less than unlisted nonfamily firms. Therefore, the further hypothesis is as follows:

H<sub>2</sub>: Unlisted family firms did not reduce their leverage significantly less than unlisted nonfamily firms.

The study finally contend that the attention to SEW, in terms of family business preservation and its consolidation, probably caused listed family companies to

take the opportunity during a lack in bank capital to increase their leverage by issuing bonds. On the contrary, listed nonfamily firms reduced their leverage because they have no particular reason to prefer bonds over shares in times of bank credit restriction. This happens especially when ownership is characterized by block holdings and because listed nonfamily companies are just not concerned about the perpetuation of the business. Thus, this study's last hypothesis:

H<sub>3</sub>: Listed family firms increased their leverage, whereas listed nonfamily firms reduced their leverage.

## METHODOLOGY

A quantitative research through data gathering, representation, and interpretation was used to infer the impact of the sovereign debt crisis on the capital structure of the firms in the GIPSI countries. The period covered by the analysis is 2011-2018. The starting year of the research is 2011 because, by the end of that year, all of the GIPSI countries were involved in the worsening of the spread problem of their public bonds. 2018 is the final year of the analysis, because the massive purchase of public bonds by the European Central Bank (as part of the quantitative easing) ended that year (albeit subsequently resumed with less intensity). The firms surveyed are listed and unlisted family and nonfamily Greek, Irish, Portuguese, Spanish, and Italian businesses, belonging to all sectors except the financial sector. The selection of only non-financial businesses enables this work to avoid the effect of financial sector regulations and specific firms' financing policies (Gottardo and Moisélo, 2014). Furthermore, following previous studies (Anderson and Reeb, 2003; Anderson et al., 2003; Barth et al., 2005; Amore et al., 2011; Croci et al., 2011; Diaz-Diaz et al., 2016), ownership is considered to identify family firms. Specifically, similar to Ramalho et al. (2018) and depending on data availability, family firms are referred to herein as firms with one or more named individuals or families jointly owning at least 50% of the equity. The use of the percentage of 50% for ownership depends on the fact that most firms in the sample are privately owned, in other words unlisted, as indicated later on. Thus, as they have concentrated ownership structures, the firms must demonstrate ownership of at least 50% to achieve actual control (Amore et al., 2011). As in Croci et al. (2011), the study chooses the debt-to-assets ratio to measure the leverage of the firms being analysed. Specifically, based on data availability, debt is equal to long-term debt plus loans in order to mainly focus on financial debt and thus avoid using other nonfinancial liabilities, such as payables or provisions. This approach tries to be coherent with that used in the theoretical corporate finance literature (Demirgüç-Kunt et al., 2020). Besides, the financial systems of the GIPSI states are bank oriented. As bank credit to firms is higher in bank-based countries as opposed to market-based ones (Bijlsma and Zwart, 2013), financial debt is mostly bank debt for firms in the GIPSI countries, especially for unlisted enterprises. Therefore, percentage changes in financial leverage tend to capture percentage changes in their bank debt.

The sample data are gathered from the Amadeus database. Amadeus is a database produced by Bureau van Dijk, which contains a detailed balance sheet and income statement information for public and private companies from 43 countries and in all sectors of activity. The initial sample includes all active non-financial Greek, Irish, Portuguese, Spanish, and Italian firms of the database, comprising 22,980 enterprises. Firms with missing observations or misleading results are excluded in order to count on a reliable representation of the changes in the indebtedness

**Table 1.** Descriptive statistics by country and firm typology.

Country	Firms								
	All	Listed	Unlisted	Family	Non-family	Listed family	Unlisted family	Listed non-family	Unlisted non-family
Greece	575	40	535	481	94	35	446	5	89
Ireland	111	0	111	59	52	0	59	0	52
Portugal	245	1	244	114	131	0	114	1	130
Spain	2,135	14	2,121	1,629	506	5	1,624	9	497
Italy	8,940	23	8,917	6,900	2,040	11	6,889	12	2,028
TOTAL	12,006	78	11,928	9,183	2,823	51	9,132	27	2,796

Source: Personal elaboration based on data available on the Amadeus database.

dimension of the firms throughout the period examined. Hence, the final sample consists of data from 12,006 businesses. For all the firms in the final sample and for each firm typology, that is, unlisted, listed, unlisted family, unlisted nonfamily, listed family and listed nonfamily, and for the entire period being analysed, the study calculates the sample means of the debt-to-assets ratio in each year. The research uses these means to construct the graphs represented and commented in the following paragraph.

## RESULTS

Table 1 shows that the majority of the firms in the sample are Italian businesses (74%), Spanish firms are the second group (18%), followed by the Greek (5%), Portuguese (2%), and Irish (1%) companies. Listed firms are very few; they prevail in Greece (40) and, on the whole, represent less than 1% of the firms being studied, demonstrating the low development of capital markets, which is a specific feature of the bank-oriented financial systems of the GIPSI countries.

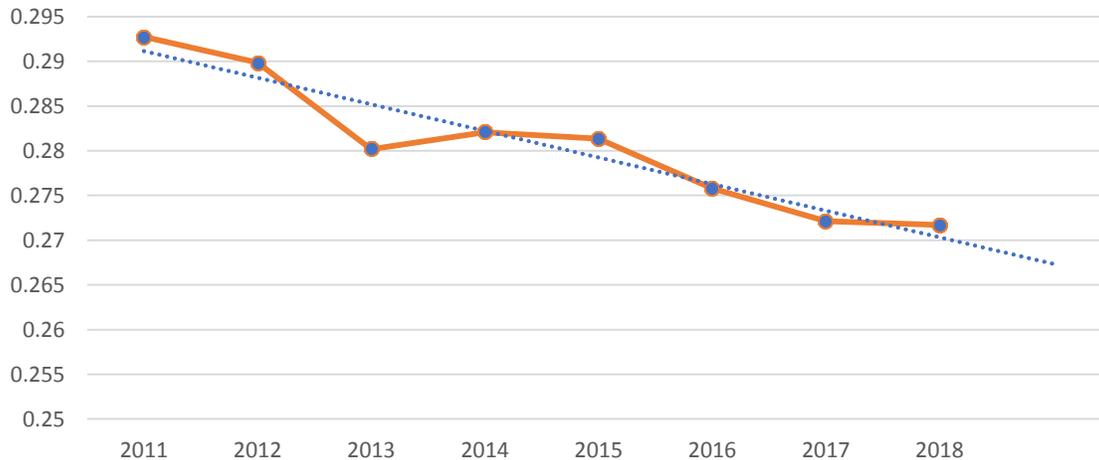
Generally speaking, family firms are a common type in these states (76%). Nonetheless, the situation changes depending on the country being considered. Family firms constitute the largest kind of business in Italy (77%) and Spain (76%); while only in Portugal, family firms cover less than half of the firms (46%). The presence or absence of "familiness" (Habbershon and Williams, 1999) for the sampled firms do not seem to characterize the ability of a firm to go or not to go public, since the distribution of the listed family firms differs across the countries under analysis. In fact, whereas 88% of the listed firms in Greece are family firms, in Italy only 48% of the listed companies are family firms, and in Spain they are 36%. Moreover, in Portugal, the only listed firm is a nonfamily one, and in Ireland, there are no listed firms at all. That also leads me to conclude that probably the need to maintain control of the family business can be ensured even when these companies obtain the listing on financial markets, thanks to the use of pyramidal structures, cross-holdings, and dual-class shares (Faccio and Lang, 2002).

If the leverage of the enterprises in the sample is

looked at, Figure 1 indicates a declining trend from 2011 to 2018. However, this movement hides two different phenomena. In fact, while the debt-to-assets ratio for the unlisted firms decreased (Figure 2), the debt-to-assets ratio for the listed companies is fairly constant throughout the period considered (Figure 3), despite the deterioration of credit offered from banks. This suggests that the listed firms, by gaining access to financial markets, were generally able to substitute the lack or scarce availability of bank capital by issuing new corporate bonds. Thus, hypothesis  $H_1$  (unlisted firms reduced their leverage, whereas listed firms did not significantly decrease their leverage) is confirmed.

As indicated by Figure 4, unlisted family and nonfamily firms essentially exhibited a reduction in their leverage from 2011 to 2018, even if there was a temporary recovery in the debt level between 2013 and 2014 for both types of businesses. The debt-to-asset ratio for the unlisted family firms was also always appreciably greater than that of unlisted nonfamily enterprises, and that demonstrates a preference for debt use on the part of family firms, owing to SEW considerations. Nevertheless, unlisted family firms were unable to counter the bank credit restriction significantly better than nonfamily firms. In fact, debt-to-assets ratio decreased by about 2 percentage points for unlisted family firms and by about 3 percentage points for unlisted nonfamily firms during the period of the analysis. Thus, unlisted family firms were unable to decrease their proportion of debt significantly less than their nonfamily counterparts. As a result, hypothesis  $H_2$  (unlisted family firms did not reduce their leverage significantly less than unlisted nonfamily firms) is also confirmed. Interestingly, though, the leverage of unlisted nonfamily firms kept on decreasing after 2015, while that of unlisted family enterprises stabilized over 2018 at about 27.5%.

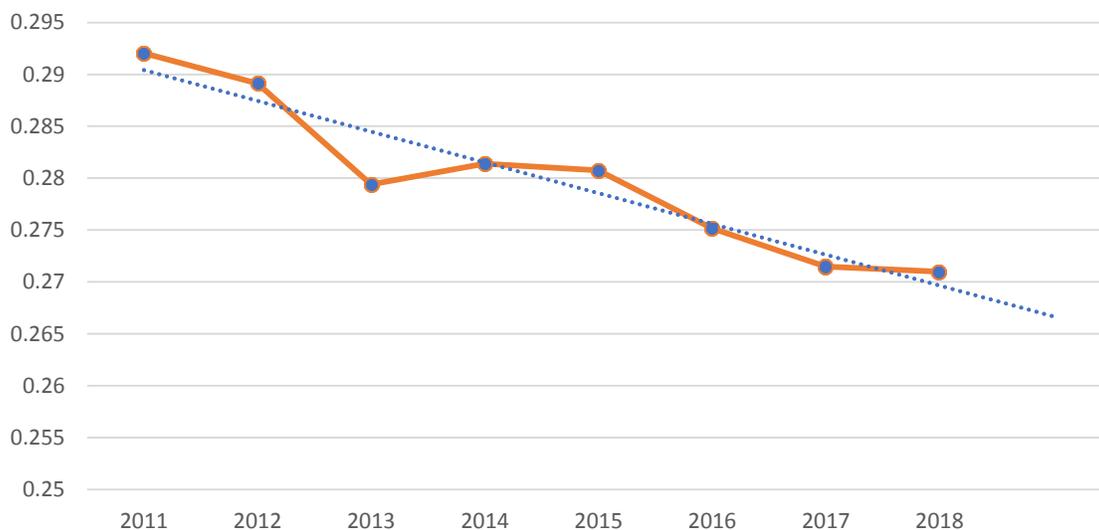
On the whole, comparison between Figures 5 and 4 first shows that listed firms rely on a larger use of debt (between about 40 and 39%) as opposed to unlisted firms (between around 29 and 27%) over 2011-2018, as listed firms can issue bonds on financial markets and finance investments through the use of debt more easily



**Figure 1.** Debt-to-assets ratio for all sampled firms

Source: Personal elaboration, based on data available on the Amadeus database.

Legend of the lines: a) \_\_\_\_\_ debt-to-assets ratio for all sampled firms; b) ..... trend line.



**Figure 2.** Debt-to-assets ratio for all sampled unlisted firms.

Source: Personal elaboration, based on data available on the Amadeus database.

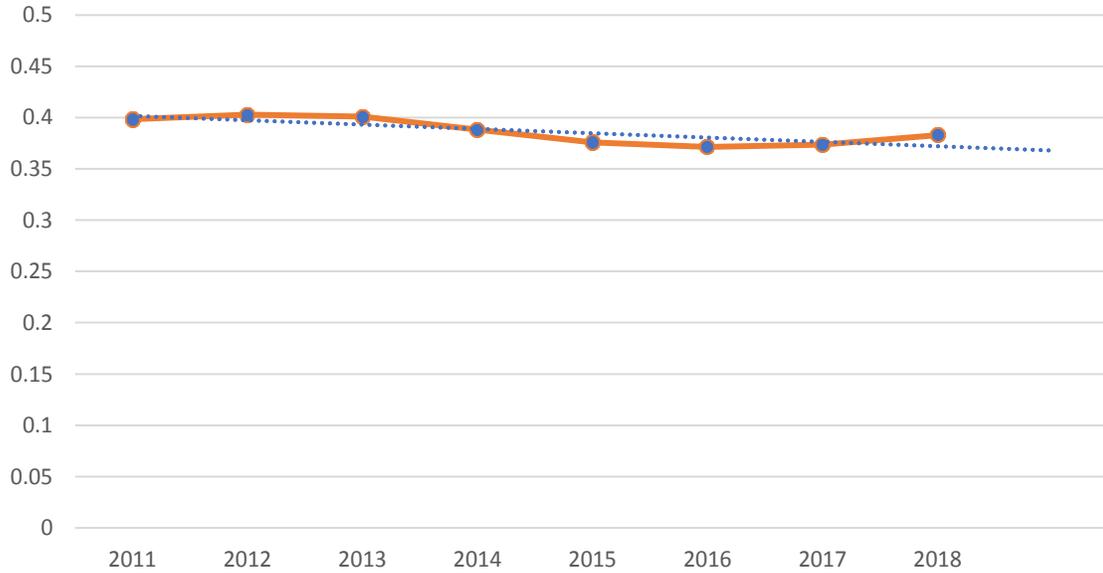
Legend of the lines: a) \_\_\_\_\_ debt-to-assets ratio for all the sampled unlisted firms; b) ..... trend line.

than unlisted firms. Secondly, when comparing listed family firms with listed nonfamily firms (Figure 5), the former essentially increased their leverage, while the latter reduced their proportion of debt capital, thus hypothesis  $H_3$  is confirmed too. One possible explanation is that listed family firms, mainly through bond issues, more than offset the scarce credit availability from banks to consolidate the family control over the business in the long run and hence strengthen their SEW preservation. In contrast, the dilution of ownership is less important in listed nonfamily firms, for which the perpetuation of the business for future generations is not an issue, especially

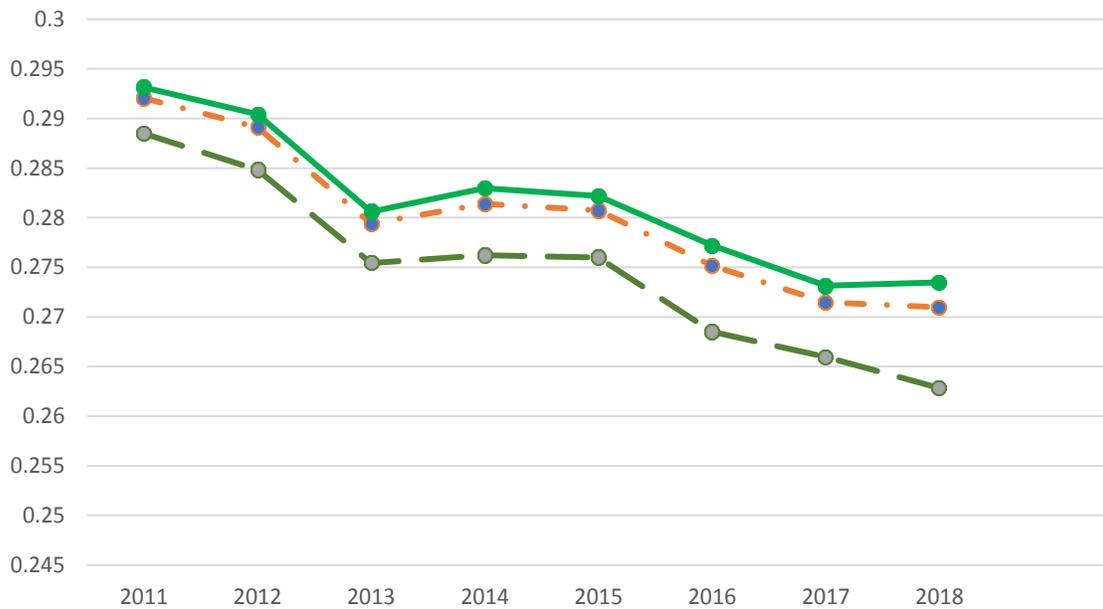
when the control share is strongly in the hands of the dominant shareholder(s). Therefore, listed nonfamily firms compensated difficult access to bank credit by either issuing shares or bonds, and a decrease in leverage for these businesses can be justified. Nonetheless, this intuition could be investigated further.

## Conclusion

This article analyses the effect of the sovereign debt crisis that began in 2009 on the capital structure choices



**Figure 3.** Debt-to-assets ratio for all sampled listed firms.  
 Source: Personal elaboration based on data available on the Amadeus database.  
 Legend of the lines: a) \_\_\_\_\_ debt-to-assets ratio for all the sampled listed firms; b) ..... trend line.

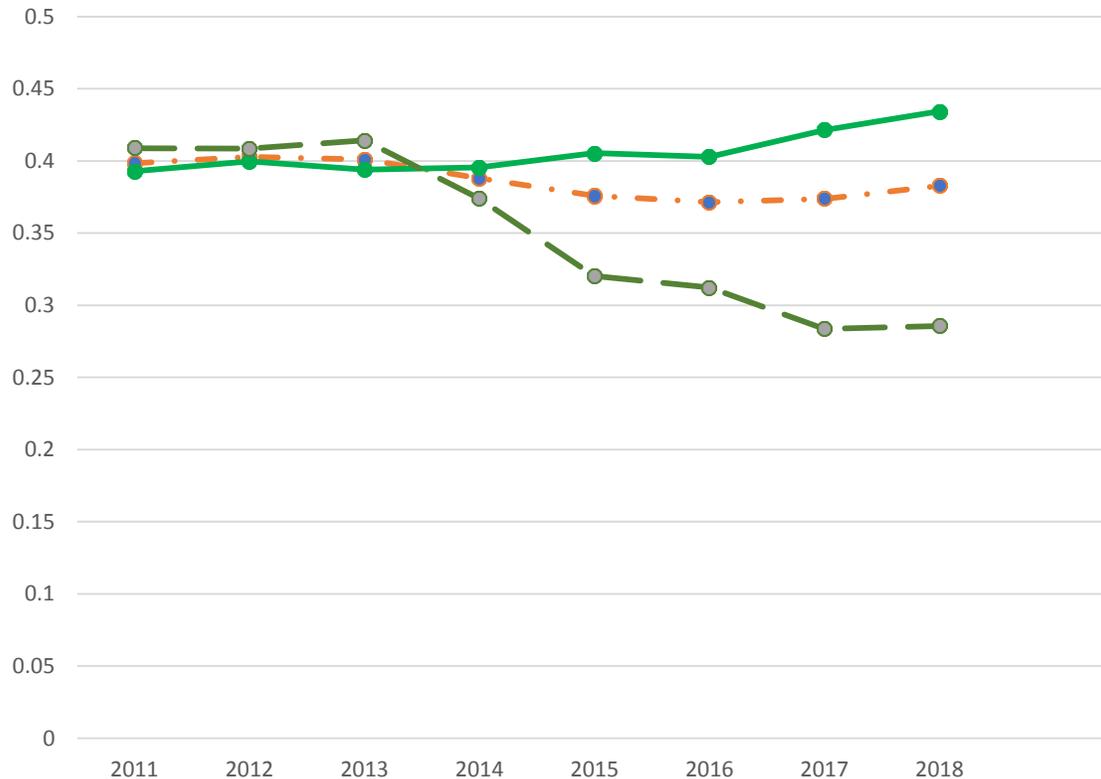


**Figure 4.** Debt-to-assets ratio for all the sampled unlisted family and nonfamily firms  
 Source: Personal elaboration, based on data available on the Amadeus database.  
 Legend of the lines: a) . . . . . debt-to-assets ratio for all the sampled unlisted firms; b) \_\_\_\_\_ debt-to-assets ratio for the sampled unlisted family firms; c) \_\_\_ \_\_\_ debt-to-assets ratio for the sampled unlisted nonfamily firms.

of listed and unlisted family and nonfamily firms in the GIPSI countries using a sample of 12,006 enterprises. The reduced bank credit availability (supply) that followed the sovereign debt crisis had a different impact on the leverage of the firms in GIPSI countries due to their

characteristics. The results of the research are as expected, because all the three hypotheses ( $H_1$ ,  $H_2$  and  $H_3$ ) stated are confirmed.

Unlisted firms reduced their leverage, whereas listed firms did not significantly decrease their indebtedness



**Figure 5.** Debt-to-assets ratio for all the sampled listed family and nonfamily firms

Source: Personal elaboration, based on data available on the Amadeus database.

Legend of the lines: a) . . . debt-to-assets ratio for all the sampled listed firms; b) \_\_\_\_\_ debt-to-assets ratio for the sampled listed family firms; c) \_\_\_ debt-to-assets ratio for the sampled listed nonfamily firms.

(H<sub>1</sub>). Unlisted firms were forced to decrease their leverage because of their reliance on bank credit, whereas listed companies were generally able to essentially maintain their indebtedness thanks to financial market access.

Unlisted family firms did not reduce their leverage significantly less than unlisted family firms (H<sub>2</sub>). Despite their orientation to SEW and its safeguard, unlisted family firms could not decrease their debt-to-assets ratio significantly less than unlisted nonfamily firms, because of their dependence on the financial sources provided by banks.

Listed family firms increased their leverage, whereas listed nonfamily firms reduced their leverage (H<sub>3</sub>). The inclination to SEW probably allowed the listed family firms to take advantage of the lack in bank financing to increase their leverage through bond issues, thus reaching a higher level of SEW protection. In contrast, listed nonfamily firms reduced the relative amount of debt employed, because they are not concerned about the continuation of the business for future generations, and hence, they do not discriminate between bond and share issues, especially in the case of concentrated ownership.

This work joins in the debate concerning the effects on capital structure decisions of firms in GIPSI countries, generated by the reduction in bank lending, following the

sovereign debt crisis. In this framework, no matter the underlying reasons of this reduction and their effective role, businesses from GIPSI countries reacted differently to reduced supply of bank credit, on the basis of their possibility of accessing financial markets and orientation toward debt sources. Compared to previous studies - covering this issue and analyzing specific sources of bank credit (Acharya et al., 2018), focussing on SMEs to understand their ability of obtain bank credit (Corbisiero and Faccia, 2020), assessing firms with different dimension, without dealing with their family nature or not (Demirgüç-Kunt et al., 2020), concentrating on a specific GIPSI country (Jiménez et al., 2012; Bofondi et al., 2013) - the work adopts a broader perspective. In fact, it allows for an understanding of the financial behaviour of the listed vs. unlisted firms on the one side, and family vs. nonfamily ones on the other, shedding new light on the impact of credit rationing on firms of different characteristics.

One lesson learned is that issuing securities in financial markets is important to cope with sudden and unexpected events which may undermine the possibility of accessing bank lending. Therefore, GIPSI countries should favour or develop financial markets dedicated to smaller firms, for which capital requirements for listing

should be adequate to them. Moreover, on this line of reasoning, the study also asserts that the growth of alternative sources of financing, as opposed to bank credit, is needed for businesses to prepare for macroeconomic shocks, especially for unlisted firms belonging to bank-oriented financial systems, such as those within the GIPSI countries. The issue of alternative sources of financing appears to be of major importance, and policy makers should tackle it very carefully, especially in the recent context of the COVID-19 health crisis. In fact, in such a situation, bank interventions and provisions, even when adequately supported and facilitated by governments, may not be sufficient. Hence, further development of other channels of financing, for example, development of venture capital, direct lending or FINTECH activities, is required to effectively sustain the real economy

Owing to lack of information and data, the study did not distinguish between the firms of different generations and thus the role of the different intensity of SEW and its related impact in explaining capital structure choices in the situation being analysed. Moreover, for the same reason, the study could not appraise the effective influence of block holding ownerships in determining the choice of equity relative to debt in listed nonfamily firms in GIPSI countries and therefore also the different trend of the leverage of listed family firms versus listed nonfamily ones over the sovereign debt crisis. Therefore, future research could address these issues in depth thus enhancing the knowledge of how firm financing changes as a consequence of the scarce credit availability, following the sovereign debt crisis involving firms in GIPSI countries.

## CONFLICT OF INTERESTS

The author has not declared any conflict of interests.

## REFERENCES

- Acharya VV, Eisert T, Eufinger C, Hirsch C (2018). Real Effects of the Sovereign Debt Crisis in Europe: Evidence from Syndicated Loans. *The Review of Financial Studies* 31(8):2855-2896.
- Albertazzi U, Marchetti DJ (2010). Credit supply, flight to quality and evergreening: an analysis of bank-firm relationships after Lehman. Bank of Italy (No. 756). Working Paper pp. 1-51.
- Amore MD, Minichilli A, Corbetta G (2011). How do managerial successions shape corporate financial policies in family firms? *Journal of Corporate Finance* 17(4):1016-1027.
- Anderson RC, Mansib SA, Reeb DM (2003). Founding family ownership and the agency cost of debt. *Journal of Financial Economics* 68(2):263-285.
- Anderson RC, Reeb DM (2003). Founding-Family Ownership and Firm Performance: Evidence from the S&P 500. *Journal of Finance* 58(3):1301-1328.
- Barth E, Gulbrandsen T, Schöne P (2005). Family ownership and productivity: The role of owner-management. *Journal of Corporate Finance* 11(1):107-127.
- Berle A, Means G (1932). *The Modern Corporation and Private Property*. Mcmillan. New York.
- Bijlsma MJ, Zwart GTJ (2013). The changing landscape of financial markets in Europe, the United States and Japan. Bruegel Working Paper 2013/02.
- Blanco-Mazagatos V, de Quevedo-Puente E, Castrillo LA (2007). The trade-off between financial resources and agency costs in the family business: An exploratory study. *Family Business Review* 20(3):199-213.
- Blanco-Mazagatos V, de Quevedo-Puente E, Delgado-García JB (2016). How agency conflict between family managers and family owners affects performance in wholly family-owned firms: A generational perspective. *Journal of Family Business Strategy* 7(3):167-177.
- Bofondi M, Carpinelli L, Sette E (2013). Credit supply during a sovereign debt crisis. Banca D'Italia Eurosystema. Temi di discussione (Working papers). Number 909.
- Burgstaller J, Wagner E (2015). How do family ownership and founder management affect capital structure decisions and adjustment of SMEs? Evidence from a bank-based economy. *Journal of Risk Finance* 16(1):73-101.
- Busetti F, Cova P (2013). L'Impatto Macroeconomico Della Crisi Del Debito Sovrano: Un'Analisi Controfattuale Per L'Economia Italiana (The Macroeconomic Impact of the Sovereign Debt Crisis: A Counterfactual Analysis for the Italian Economy). Bank of Italy Occasional Paper, (201).
- Cheng Q (2014). Family firm research – A review. *China Journal of Accounting Research* 7(3):149-163.
- Cingano F, Manaresi F, Sette E (2016). Does Credit Crunch Investment Down? New Evidence on the Real Effects of the Bank-Lending Channel. *The Review of Financial Studies* 29(10):2737-2773.
- Corbisiero G, Faccia D (2020). Firm or bank weakness? Access to finance since the European sovereign debt crisis. Working papers. European Central Bank. Number 2361. pp. 1-44.
- Croci E, Doukas JA, Gonenc H (2011). Family Control and Financing Decisions. *European Financial Management* 17(5):860-897.
- Demsetz H, Lehn K (1985). The Structure of Corporate Ownership: Causes and Consequences. *Journal of Political Economy* 93(6):1155-1177.
- Demirgüç-Kunt A, Martínez Peria MS, Tresselt T (2020). The global financial crisis and the capital structure of firms: Was the impact more severe among SME and non-listed firms? *Journal of Corporate Finance* 60(C):1-32.
- Diaz-Diaz NL, García-Teruel PJ, Martínez-Solano P (2016). Debt maturity structure in private firms: Does the family control matter? *Journal of Corporate Finance* 37:393-411.
- Faccio M, Lang LHP (2002). The ultimate ownership of Western European corporations. *Journal of Financial Economics* 65:365-395.
- Fender I, Gyntelberg J (2008). Overview: global financial crisis spurs unprecedented policy actions. *BIS Quarterly Review* 13(4):1-24.
- Frank MZ, Goyal VK (2009). Capital structure decisions: which factors are reliably important? *Financial Management* 38(1):1-37.
- Gaiotti E (2013). Credit availability and investment: Lessons from the "great recession". *European Economic Review* 59(C):212-227.
- Gedajlovic E, Carney M (2010). Market, hierarchies and families: Toward a transaction cost theory of the family firm. *Entrepreneurship Theory and Practice* 34(6):1145-1171.
- Gerlach S, Schulz A, Wolff GB (2010). Banking and sovereign risk in the euro area. Discussion Paper Series 1: Economic Studies No 09/2010:1-68.
- Gomez-Mejia LR, Takacs-Haynes K, Nuñez-Nickel M, Jacobson KJL, Moyano-Fuentes J (2007). Socio-emotional wealth and business risks in family-controlled firms: Evidence from Spanish olive oil mills. *Administrative Science Quarterly* 52(1):106-137.
- Gómez-Mejia LR, Cruz C, Berrone P, De Castro J (2011). The Bind that Ties: Socio-emotional Wealth Preservation in Family Firms. *Academy of Management Annals* 5(1):653-707.
- Gottardo P, Moisello AM (2014). The capital structure choices of family firms: evidence from Italian medium-large unlisted firms. *Managerial Finance* 40(3):254-275.
- Habbershon TG, Williams ML (1999). A Resource-Based Framework for Assessing the Strategic Advantages of Family Firms. *Family Business Review* 12(1):1-25.
- Harris M, Raviv A (1991). The theory of capital structure. *Journal of*

- Finance 46:297-355.
- Iyer R, Lopes S, Peydro J, Schoar A (2014). Interbank liquidity crunch and the firm credit crunch: evidence from the 2007-2009 crisis. *Review of Financial Studies* 27(1):347-372.
- Jensen MC (1986). Agency costs of free cash flow, corporate finance, and takeovers. *American Economic Review* 76(2):323-329.
- Jensen MC, Meckling WH (1976). Theory of the firm: managerial behaviour, agency costs and ownership structure. *Journal of Financial Management* 3(4):305-360.
- Jiménez G, Ongena S, Peydró J-L, Saurina J (2012). Credit Supply and Monetary Policy: Identifying the Bank Balance-Sheet Channel with Loan Applications. *American Economic Review* 102(5):2301-2326.
- Kraus A, Litzenberger RH (1973). A State-preference Model of Optimal Financial Leverage. *Journal of Finance* 28(4):911-922.
- Kremp E, Sevestre P (2012). Did the crisis induce credit rationing for French SMEs?. *Journal of Banking and Finance* 37(10):3757-3772.
- La Porta R, Lopez-De-Silanes F, Shleifer A (1999). Corporate ownership around the world. *The Journal of Finance* 54(2):471-517.
- Michiels A, Molly V (2017). Financing Decisions in Family Businesses: A Review and Suggestions for Developing the Field. *Family Business Review* 30(4):369-399.
- Modigliani F, Miller MH (1958). The Cost of Capital, Corporation Finance and the Theory of Investment. *American Economic Review* 48(3):261-297.
- Monti E (2009). *Manuale di finanza per l'impresa*. Isedi, Torino.
- Mork R, Shleifer A, Vishny R (1988). Management ownership and market valuation: An empirical analysis. *Journal of Financial Economics* 20:293-315.
- Myers SC (1977). Determinants of Corporate Borrowing. *Journal of Financial Economics* 5(2):147-175.
- Myers SC (1984) The Capital Structure Puzzle. *Journal of Finance* 39(3):575-592.
- Myers SC, Majluf NS (1984). Corporate Financing and Investment Decisions When Firms Have Information That Investors Do Not Have. *Journal of Financial Economics* 13(2):187-221.
- Naldi L, Cennamo C, Corbetta G, Gomez-Mejia, L (2013). Preserving Socio-emotional Wealth in Family Firms: Asset or Liability? The Moderating Role of Business Context. *Entrepreneurship Theory and Practice* 37(6):1341-1360.
- Popov A, Udell GF (2010). Cross-border banking and the international transmission of financial distress during the crisis of 2007-2008. European Central Bank, Working paper pp. 1-49.
- Presbitero AF, Udell GF, Zazzaro A (2012). The home bias and the credit crunch: A regional perspective. *Journal of Money, Credit and Banking* 46(s1):53-85.
- Puri M, Rocholl J, Steen S (2011). Global retail lending in the aftermath of the US financial crisis: distinguishing between supply and demand effects. *Journal of Financial Economics* 100(3):556-578.
- Rajan RG, Zingales L (1995). What Do We Know about Capital Structure? Some Evidence from International Data. *Journal of Finance* 50(5):1421-146.
- Ramalho JS, Rita RMS da Silva JV (2018). The impact of family ownership on capital structure of firms: Exploring the role of zero-leverage, size, location and the global financial crisis. *International Small Business Journal: Researching Entrepreneurship* 36(5):574-604.
- Ross S (1973). The economic theory of agency: The principal's problem. *American Economic Review* 63:134-139.
- Rottmann H, Wollmershäuser T (2013). A micro data approach to the identification of credit crunches". *Applied Economics* 45(17):2423-2441.
- Shambaugh JC (2012). The Euro's Three Crises. *Brookings Papers on Economic Activity* Spring 2012. Available at: <http://citeseerx.ist.psu.edu/viewdoc/summary?doi=10.1.1.228.9892>
- Shleifer A, Vishny RW (1986). Large Shareholders and Corporate Control. *Journal of Political Economy* 94(3):461-488.
- Smith C, Warner J (1979). On financial contracting: An analysis of bond covenants. *Journal of Financial Economics* 7:117-161.
- Soana M G, Verga G, Gandolfi G (2013). Are Private SMEs Financially Constrained During the Crisis? Evidence from the Italian Market. Working paper. September 9:1-21.
- Steijvers T, Niskanen M (2014). Tax aggressiveness in private family firms: An agency perspective. *Journal of Family Business Strategy* 5(4):347-357.
- Villalonga B, Amit R, Trujillo MA, Guzmán A (2015). Governance of family firms. *Annual Review of Financial Economics* 7:635-654.
- Zellweger TM, Nason RS, Nordqvist M, Brush CG (2011). Why Do Family Firms Strive for Nonfinancial Goals? An Organizational Identity Perspective. *Entrepreneurship Theory and Practice* 37(2):229-248.

*Full Length Research Paper*

# Does gender diversity matter for risk-taking? Evidence from Italian financial institutions

Elisa Menicucci<sup>1\*</sup> and Guido Paolucci<sup>2</sup>

<sup>1</sup>Department of Business Studies, University of Roma Tre, Rome, Italy.

<sup>2</sup>Department of Management, Polytechnic University of Marche, Ancona, Italy.

Received 12 August, 2020; Accepted 24 September, 2020

The aim of this study is to investigate the relationship between gender diversity and the risk profile of Italian financial institutions during the period 2013 to 2019. The paper examines whether the presence of top executives has any significant effect on corporate risk-taking. A sample of 160 Italian financial institutions was analyzed and a multivariate regression model was developed considering five risk dimensions to verify the effect of gender diversity. The results suggest that female Chief Executive Officers (CEOs), Chief Financial Officers (CFOs) and Chairmen of the Board of Directors (CHAIRs) are considerably less overconfident and less risky than their male colleagues, thus confirming a negative causation between gender diversity and risk-taking. The findings reveal that financial institutions headed by women are more risk averse since they account upper capital adequacy and equity to assets ratios. As credit risk in female-run financial institutions is no diverse from male-run financial institutions, higher capital adequacy does not come from minor asset quality because it is related to the greater risk aversion of female top managers.

**Key words:** Gender diversity, female directors, female xsass, risk-taking, Italian financial institutions.

## INTRODUCTION

The effect of gender diversity on performance and riskiness of a firm has been the focus of a number of studies in economic and finance literature for many years. The literature on board diversity has appealed a growing interest in the last few years as many studies investigated the impacts of women holding leadership positions on corporate performance and corporate governance (Burgess and Tharenou, 2002; Carter et al., 2003; Adams and Ferreira, 2004, 2009; Farrell and Hersch, 2005). Furthermore, many researchers and economists questioned whether growing involvement of women as

CEOs or as directors in the board could have limited undue leverage and riskiness in the financial sector. However, the financial literature does not yet fully examine how the presence of female executives could influence risk in financial institutions and this topic has yet to be inspected particularly in financial industry. Gender diversity in boards of directors has turned into a relevant topic particularly in the financial sector since there is a significant gap between the share of women employed in financial institutions and their presence among bank managers. Even though the market of labor is now nearly

Corresponding author. E.Menicucci@Staff.Univpm.It.; e.menicucci@univpm.it.

Author(s) agree that this article remain permanently open access under the terms of the [Creative Commons Attribution License 4.0 International License](https://creativecommons.org/licenses/by/4.0/)

equal, women have a very limited admission to higher echelons and their representation percentage in corporate decision-making bodies is still small.

The small representation of women in the upper executive positions of European financial institutions is usually associated to the phenomenon known as the glass ceiling. This is typically pictured as a set of difficulties that produces an inaccessible obstacle made up of structures, procedures, power relations, habits or beliefs that confuse the access of a woman to high directive positions (Powell and Butterfield, 1994; Adams and Funk, 2012). These characteristics may signal the presence of a glass ceiling in prior steps of the professional career of female executives, decreasing the number of possible candidates. This would suggest that a limited group of female candidates is available for the selection of a director. In such a context, the stereotypical female risk aversion is found on psychological and sociological studies (Atkinson et al., 2003). Hence, the risk adverse attitude of women is claimed to be one of the reasons why women do not reach top positions compared to men, as achieving a top position within a firm or a financial institution requires a somewhat risky attitude.

The purpose of this study is to examine the effect of gender diversity on risk-taking behavior of Italian financial institutions. The empirical results show that banks with a woman in top management positions [Chief Executive Officer (CEO), Chief Financial Officer (CFO) or Chairperson of the Board of Directors – (CHAIR)] exhibit lower levels of risk-taking variables. We assume that the gender-based behavioral variances between men and women are reproduced in the decisions of top executives and directors, inducing the main financial and strategic decisions of their firms in terms of risk appetite. For a sample of 312 Italian financial institutions, the results show a negative relationship between board gender diversity and corporate risk-taking. These findings state that women are more risk hostile than their male colleagues and especially the presence of female executives negatively impacts on the risk profile of the financial institutions significantly. Moreover, even after using many robustness tests, we find a significant suggestion that a large female representation within the board of directors or in top managerial positions affects the risk profile of the Italian financial institutions.

## LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Studies in the extent of behavioral finance harassed the possible effect of personal characters like gender diversity on financial results (Barber and Odean, 2001). Regarding the variances in risk aversion between women and men, prior literature is prone to demonstrate a superior risk aversion of women in investment decisions (Jianakopoulos and Bernasek, 1998; Agnew et al., 2003), explaining this

conclusion by the minor self-confidence of women than men (Barber and Odean, 2001). Regarding corporate investment decisions, risk-taking behavior may diverge between male and female executives and especially the presence of a female CEO can affect the risk-taking behavior of financial institutions. Nevertheless, the literature is less conclusive since some authors observed a negative relationship between firm risk and the attendance of female directors (Farrell and Hersch, 2005), while others found an opposite result (Adams and Funk, 2012).

### Gender diversity and corporate risk-taking

Risk-taking is a significant concern of human behavior as it depends on whether the particular behavior could lead to a specific result and whether some of these consequences are disagreeable or unwelcome (Byrnes et al., 1999). Thus, risk-taking comprises the decision-making of choices that could induce to negative consequences. Differences in gender-based behavioral have been broadly inspected in the behavioral finance and cognitive psychology's literature. According to numerous researchers in this area, risk-taking is related to behavioral differences between men and women as they act and behave differently. The main agreement of studies on the comparison between women and men in terms of risk preferences displays that men are more likely to take risks than women (Jianakoplos and Bernasek, 1998; Sundén and Surette, 1998; Charness and Gneezy, 2012). The differences are explicated by biological factors (that is genetic differences between women and men) and are related to information processing, diligence, conservatism, psychological and social considerations, overconfidence and risk tolerance. In fact, women are less confident than their male counterparts in general (Barber and Odean, 2001; Niederle and Vesterlund, 2007) as they are less likely to aggressively behave and to take very risky decision in professional situations. Some economic and psychological studies suggest a gender-specific explanation in risk aversion as women are found to be more risk averse, than men, for instance in trading behavior. In prior literature, Sundén and Surette (1998) demonstrated that women are less incline to opt for risky assets, particularly if they are maiden because they perceive higher risks in this case. Likewise, not married women tend to be considerably more risk hostile when they allocate their total household wealth (Jianakoplos and Bernasek, 1998). Anyway, the high risk aversion of women is a gender difference that consistently is highlighted in the literature (Croson and Gneezy, 2009; Charness and Gneezy, 2012). Regarding the presence of women in top managerial positions, Francis et al. (2015) offered a significant suggestion for a greater risk aversion and a upper degree of accounting conservatism of female CFOs compared to men's colleges. In a similar vein,

Francis et al. (2014) suggested that female CFOs are less tax-aggressive.

Also, the effects of gender-based behavioral variances for financial decisions in a professional setting have received growing attention in the literature over the last years (Barber and Odean, 2001; Fehr-Duda et al., 2006; Sarin and Wieland, 2016). Furthermore, prior literature suggested that women are more risk averse and conservative than men since they show less risky behavior in individual investment decisions (Jianakoplos and Bernasek, 1998; Barber and Odean, 2001; Dwyer et al., 2002; Agnew et al., 2003; Watson and McNaughton, 2007). Also in the context of corporate investment decisions there is a huge set of empirical data on whether the presence of women in boardrooms favors risk-taking (Cosentino et al., 2012; Faccio et al., 2016), but literature is still less convincing. The research evidence in literature about the influence of gender diversity on corporate risk-taking is varied and the empirical findings are sometimes inconclusive. These investigations can be shared into two groups: those who show that gender diversity decreases the company's risk and those who prove a positive influence or no indication of women generating an influence on corporate risk.

Farrell and Hersch (2005), Croson and Gneezy (2009), De Cabo et al. (2012) and Peni (2014) explored the impact of female leaders on investment decisions and on the risk profile of the company. The agreement of these authors is that women are more risk averse in the strategic decisions, reducing the exposure of the company to risk. The main subject in favor of the inverse relation between female managers and business risk is the variances in risk appetite based in gender diversity. Psychological and psychiatric valuations determined that women are incline to be more risk averse than male peers. The fundamental idea in the empirical investigation is that gender-based variances in risk tolerance and overconfidence persist in the professional setting where the managers' risk preferences impact on the financial decisions of the company. On the contrary, Adams and Funk (2012) affirmed a positive relationship between female directors and firm risk while other studies (Loukil and Yousfi, 2016; Sila et al., 2016) presented no significant correlations between board gender diversity and the tendency to take financial or strategic risk-taking.

### **Women in top managerial positions and financial risk-taking**

A few studies explored the effect of gender in financial institutions and especially about its effect on risk profile, the majority of the literature found that women are less self-confident and more risk averse than men. The main hypothesis is that risk-taking behavior varies between male and female executives in financial institutions as women engage in less risky undertakings, diminishing the bank's level of risk exposure. Prior findings in literature

concluded the risk aversion of the female leaders (Bellucci et al., 2010; Elsaid, 2014; Palvia et al., 2015; Faccio et al., 2016; Sila et al., 2016; Skala and Weill, 2018) and in particular, evidence showed that there is a statistical and economic significant role of CEO gender diversity for corporate risk decisions (Elsaid and Ursel, 2011). Moreover, companies having female CEOs count more steady earnings and lower leverage, so that they are able to better survive during a crisis period than those run by male CEOs. Likewise, Wu and Truong (2014) suggested that the presence of a female executive helps to reduce risky financial decisions. In this regard, two papers focused on loan officers' gender and they discovered that the default rates of loans attributable to women are lesser than men's ones (Beck et al., 2013).

On the contrary, a minority of prior studies demonstrated that the attendance of women on board raises the risk of the firms. For example, Adams and Funk (2012) concluded that Swedish women directors are more risk-loving than male directors. Also, Berger et al. (2014) reported that the risk of the financial portfolio rises if the proportion of female executives on the board of directors increases. Berger et al. (2014) inspected the effects of directors' traits in board on risk-taking in German banks and they documented a positive relationship between female directors in boards of banks and portfolio risk.

Similarly, Zigraiova (2015) studied how the banks' board composition can impact on risk-taking behavior for a sample of Czech bank. She obtained mixed evidence that the percentage of female directors affects the risk-taking behavior of banks depending on the different forms of Czech banks and the diverse risk variables.

The topic of the study is whether women in top management influence the risk policy of a financial institution since females are more risk avoiding than men according to most cited literature. Since women are usually less prone to take risks and are more conservative, we hypothesize that female CEOs, CFOs and CHAIRs evaluate risks more conservatively, thus holding higher level of equity capital and reducing default risk of their institutions. Hence, the hypothesis is that financial institutions with lower levels of riskiness tend to have more women in top management positions. Based on the literature review, the following research questions are proposed:

H1: There is a negative relationship between female CEO and corporate risk-taking

H2: There is a negative relationship between female CFO and corporate risk-taking

H3: There is a negative relationship between female CHAIR and corporate risk-taking

## **DATA AND METHODOLOGY**

### **Data**

This study explores the impact of gender diversity on risk-taking in

the Italian financial institutions. The sample is restricted to financial institutions located in Italy as they are broadly subjected to similar regulatory and governance backgrounds. The Italian financial system (as those in other states such as Germany, Austria, Switzerland and Spain) has few large internationally active financial institutions and it is characterized by small and medium-sized financial companies. The selection procedures of the population result in a sample of 160 Italian financial institutions that are all geographically localized and active in Italy according to the Bankit bulletin statistics updated to December 31, 2019 for Italian banks. The final sample consists of 1,120 year observations from 2013 to 2019. Different types of financial institutions operate in Italy: brokerage firms (SIM), asset management companies (SGR), leasing companies, factoring companies, payment institutions, electronic money institutions (IMEL). We exclude banks from the definition of financial institutions.

The preliminary data meet the following requirements:

- i) it is required that the financial institutions are Italian;
- ii) it is required that the financial institutions are active over the period 2013-2019;
- iii) balance sheet variables and information on corporate governance over the period 2013-2019 must be available;
- iv) the Italian branches of international financial institutions, payment institutions, electronic money institutions (IMEL) are excluded from the sample.

Starting from the entire population of Italian financial institutions, we first remove from the sample the institutions that do not meet these requirements. Doing so reduces the number of financial institutions from 312 to 160 in the final sample. Data of corporate governance were manually collected from annual reports that have been downloaded from the institutions' websites. This dataset has three main benefits for the study of the association between gender diversity and the risk profile of each institution.

First, the attendance of women in top managerial positions (CEO, CFO and CHAIR) is very frequent in the sample so that the investigation is not influenced by the specific traits of a particular woman in a top managerial position. Second, the sample is large and homogenous as all the selected institutions carry out related financial activities, under the same supervision of Bank of Italy and European Central Bank (BCE) and thus within the same regulatory environment. They are small, medium and large financial institutions predominantly involved in corporate, investment and commercial financial activities. Hence, differences in risk through the institutions are not affected by a specific business model. Third, all the financial institutions have a simple and small management structure so that the impact of female on corporate decision-making is better identified than in compound corporate governance structure where it is harder to separate the role of female executives and their individual characteristics on fundamental decisions.

## Variables measurements

### Gender diversity variables

Gender diversity is the independent variable taken into account. We proxy this variable regarding top managerial positions using three measures as follows: (i) a dummy variable (F\_CEO) that equals to 1 if there is a woman holding the position of Chief Executive Officer (CEO), and to 0 otherwise; (ii) a dummy variable (F\_CFO) that equals to 1 if there is a woman holding the position of Chief Financial Officer (CFO) and to 0 otherwise; (iii) a dummy variable (F\_CHAIR) that equals to 1 if there is a woman holding the position of Board Chairperson (CHAIR) and to 0 otherwise. These three explanatory variables are used to proxy gender diversity because they undoubtedly embody the most powerful management positions within the strategic decision-making process of the institution.

The data about the female CEOs, CFOs and CHAIRs are based on a personal background inquiry. To build the research, the profile of top executives was manually extracted largely from the annual reports, web sites and other appropriate sources such as AIDA and news releases. When these sources do not deliver satisfactory information, we switch to other sources until we find the needed information. In this case, the investigation is done through searching for the name of a director in social media such as, Linked-In and Facebook or researching for the name in director databases, according to the availability of required data in a certain database (e.g. Bloomberg, Boardroom insiders, Checkdirector).

### Dependent variables

To analyze how gender diversity impacts on risk-taking, five alternative conventional measures of financial risk were applied that is CAR, CR, Z-score, NPL ratio and LLP ratio. The key explained variable for risk-taking is the Capital Adequacy Ratio (CAR) stated by the financial institution. The CAR - also known as Capital to Risk (weighted) Assets Ratio, is the ratio of the financial institution's capital to its risk and it represents the most comprehensive measure about the maintenance of more or less conservative risk appetite. We also consider the Capital Ratio (CR) that is measured as the ratio of the financial institution's Total Equity Capital to Total Assets. CR is included in the model as an additional and complementary risk measure that explains whether capital is detained based on risk weightings or it is a nominal reserve buffer against adversative events. Then, we keep in mind the Z-score, which is usually expected as an indicator of insolvency risk in prior studies (Berger et al., 2009). Z-score has been commonly applied to examine the determinants of risk-taking and it has been widely used to capture financial stability of companies (Agoraki et al., 2011; Altunbas et al., 2012; Anginer et al., 2014, Lepetit and Strobel, 2015). Z-score specifies the number of standard deviation that the return on assets (ROA) has to go down below the expected value in order to reduce equity. Since Z-score is contrariwise related to the likelihood of insolvency, a high Z-score shows a low probability of failure. We also embrace in the estimations the ratio of Non-performing (Impaired) Loans to Total Loans (NPL ratio) and the ratio of Loan Loss Provisions to Total Loans (LLP ratio) as alternative measures of risk. NPL ratio is a common risk proxy as it is a credit quality measure regarding the operational activity of the financial institution (Yeyati and Micco, 2007; Berger et al., 2009; Agoraki et al., 2011; Schaeck and Cihák, 2012). Non-performing loans are those that have previously defaulted and loan loss provisions account for the related realized losses. LLP ratio is the incurred cost to banks of adjusting the loan loss reserve divided by total loans. Both ratios mirror the existing credit risk, but also the concerns of previous policy led by CEO.

### Control variables

To add control variables in the regression model, the literature on the causes of financial risk were analyzed (Berger et al., 2014; Sghaier and Hamza, 2018; Skala and Weill, 2018). The selected control variables are the most common ones in earlier studies on the topic of gender diversity and risk policies of financial institutions. According to previous literature (Palvia et al., 2015; Skala and Weill, 2018), we include in the model the size of the financial institution as a control variable and defined it as the natural logarithm of total assets (Size). As a large board has superior chance of counting female members, board size were taken into account as the number of directors in board (BoardSize) and we also consider board independence as the number of independent directors (BoardIndep). Also, considered the relation of Loans to Assets (ShareLoans) and the business model of the institution, counted by the share of fees

within the total operating income (ShareFee) were considered. Then, we finally controlled for the macroeconomic environment and local market conditions using the amount of registered unemployment in the region where the financial institution is headquartered (Unemployment) (Table 1).

$$RT_{i,t} = \alpha_0 + \beta \text{Gender diversity}_{i,t} + \gamma \text{Control variables}_{i,t} + \varepsilon_{i,t}$$

Where,  $i$  refers to a financial institution;  $t$  refers to year and  $\varepsilon_{i,t}$  is a stochastic error term. Gender diversity is defined as the described above alternative female proxies: (i) F\_CEO, (ii) F\_CFO (iii) F\_CHAIR. The full list of the alternative risk measures and gender variables are contained in Table 2. To measure the influence of female executives on risk-taking, we also control for the variables that could possibly impact on the bank's risk appetite. Also these variables are summarized in Table 2.

To verify the hypotheses, we applied a linear regression model using OLS method because of its general quality of minimized bias and variance (Greene, 2004). In line with Baltagi (2001), we used panel data, which give more variability and less collinearity among the variables. The model has a number of predictors and we controlled for individual heterogeneity using a fixed effects estimation with standard errors clustered at the institution level. The choice of a fixed effects model rather than a random effects one has been confirmed with Hausman test (Baltagi, 2001). We also employed the Breusch-Pagan test to check for residual heteroscedasticity. We removed the firm-level heterogeneity through the application of cross-sectional mean deviation data (Greene, 2004). Because of the dynamic nature of this model, the least squares estimation methods produce biased and inconsistent evaluations. Therefore, we used techniques for dynamic panel estimation that deal with the biases of the estimates. To handle issues related to endogeneity, the identification of exogenous changes in gender characteristics is made by applying difference-in-difference estimation techniques as in Berger et al. (2014) to exploit exogenous changes in board composition rising from mandatory executive retirements. Concerning the presence of a causal effect from gender diversity to risk-taking behavior, the reverse causality problem is addressed by the means of instrumental variables methods, hypothesizing that the fraction of male directors with board relationships to female directors could be a valid mechanism for the fraction of female directors.

## RESULTS AND DISCUSSION

This section inspects the effect of different gender diversity variables on risk-taking. The descriptive statistics of the variables are comprised in Table 3 for the entire sample.

The findings show that the number of women attending on top positions is low in Italian financial institutions. A key remark is that on average the percentages of female CFOs and CEOs of financial institutions are of 29.0 and 26.0% respectively. On average, the proportion of female CHAIRs is even lower as the Board Chairperson is a woman only in 14.0% of financial institutions. This percentage is small compared to the number of female executives in Italian industrial companies. In this regard, we can claim that women are still missing in top managerial positions. The partial attendance of women in such these working roles can be justified by the

### The model

To investigate how bank risk-taking (RT) is influenced by gender diversity, the research model can be explained as follows:

phenomenon of glass ceiling, limiting women's ingress in the influential positions in the hierarchy. We also note that mean age of female and male executives is very similar, suggesting that gender is not influenced by an age variable. We calculate the Pearson correlations to observe the relationships between the gender diversity measures and the explanatory variables. Table 4 portrays the correlation coefficients between the variables included in the regression model.

The matrix (Table 3) indicates that the correlation between the variables is not robust. The values display that multicollinearity does not appear to be a severe issue, since it is found far under the critical value. The correlation coefficients confirm that the model is reliable since the correlation between each of the variables is not high and the highest grade of it is very acceptable. We make estimates by means of the mentioned five risk variables alternatively and we look at the effects of the explanatory variables (F\_CEO, F\_CFO, F\_CHAIR) on risk-taking of Italian financial institutions. The findings are exposed in Table 4.

The results demonstrate that Italian financial institutions handled by female executives, record a much smaller variation in risk-taking than those run by men in top management positions. In particular, female CFOs have a negative and significant (significance at the 0.01 level) effect on risk-taking, supporting the view that women are more risk averse than men in making financial decisions. Also female CEOs and CHAIRs heading financial institutions are related with higher risk aversion contributing to drop amounts of corporate risk (significance at the 0.05 level).

The empirical results reveal that the behavioral differences between men and women may have significant consequences for corporate financial decisions. These findings confirm the hypothesis and converge with those of Faccio et al. (2016), Huang and Kisgen (2013), Barua et al. (2010), Krishnan and Parsons (2008). The conclusions of these prior studies are that female executives are less confident and more risk hostile in making financial decisions than their male counterparts. The economic effect of gender on capital ratios (CAR and CR) is strong especially for F\_CEO and F\_CFO, suggesting that female-led financial institutions hold upper levels of capital buffers. The high estimation of capital ratios does not originate from minor asset quality, because no variance is detected for credit risk indicators between male-led and female-led financial institutions.

The outcomes presented in Table 4 attest that no

Table 1. Explanation of variables.

Variable	Description measure	Formula
<b>Dependent variable</b>		
<b>Risk-taking variable</b>		
Capital Adequacy Ratio (CAR)	The ratio of capital to total risk weighted assets in year t	$CAR_{i,t} = (\text{Tier1 capital} + \text{Tier2 capital})_i / \text{Total risk weighted assets}_t$
Capital ratio (CR)	The ratio of Equity in year t to Total Assets in year t	$CR_{i,t} = \text{Equity}_i / \text{Assets}_t$
Z-score	Natural logarithm of the relation of a sum of mean Return on Assets and Equity to assets to the standard deviation of Return on Assets	$Z\text{-score}_{i,t} = (\text{ROA}_t + \text{Equity to Assets}_i) / [\text{SD}(\text{ROA}_i)]$ with ROA that is the return on assets computed by the ratio of net income to total assets; SD(ROA) that is the standard deviation of ROA calculated for the period 2013-2019
NPL ratio	The ratio of Non-performing Loans (NPLs) in year t to Total Loans in year t	$NPL_{i,t} = \text{NPLs}_i / \text{TotalLoans}_t$
LLP ratio	The ratio of Loan Loss Provisions in year t to Total Loans in year t	$LLP_{i,t} = \text{LLPs}_i / \text{TotalLoans}_t$
<b>Independent variable</b>		
<b>Gender diversity variable</b>		
F_CEO	A dummy variable that equals to 1 if the Chief Executive Officer is female and to 0 otherwise	
F_CFO	A dummy variable that equals to 1 if the Chief Financial Officer is female and to 0 otherwise	
F_CHAIR	A dummy variable that equals to 1 if the Board Chairperson is female and to 0 otherwise	
<b>Control variables</b>		
Size	The natural logarithm of Total Assets	
BoardSize	The number of board members	
BoardIndep	The number of independent directors	
ShareLoans	The relation of Total Loans to Total Assets	
ShareFee	The share of Net Fees in Total Operating Income	
Unemployment	The level of registered employment in the region where the bank is headquartered	

important variances in credit risk estimations occur, as the coefficients of NPL and LLP for F\_CEO, F\_CFO and F\_CHAIR are not enough. Capital is also reserved for balance losses suffered on Non-Performing Loans (NPLs), when loan loss reserves are not satisfactory. In this regard, it is likely that women-led financial institutions preserve higher capital ratios because they have higher credit risk. To exclude this

assumption, we expected the equation using Non-Performing Loans (NPL ratio) and Loan Loss Provisions (LLP ratio) and we found no variances in credit risk between male- and female-led banks. Greater capital levels are not reserved to cover likely loan portfolio losses as female executives do not manage financial institutions with higher NPLs or larger Loan Loss Provisions (LLPs). Hence, the attendance of women in top managerial positions

is allied with more prudent capital adequacy ratios for the same amount of risk.

Concerning capital adequacy, we note that gender diversity measures have a considerable positive impact on capital ratios. Especially the relation between female top managers (F\_CEO and F\_CFO) and CAR is positive and statistically significant (significance at the 0.01 level), supporting the view that women appointed to

**Table 2.** Descriptive statistics of the variables (Panel data for the period 2013-2019).

Parameter	Min	Max	Mean	Std. Dev.
Capital Adequacy Ratio (CAR)	9.06	51.87	18.34	8.123
Capital ratio (CR)	6.152	40.141	13.82	4.885
Z-score	-0.177	9.946	4.34	0.922
NPL ratio	0.009	24.743	3.95	4.356
LLP ratio	-0.668	2.335	0.27	0.427
F_CEO	0	1	0.260	0.103
F_CFO	0	1	0.290	0.375
F_CHAIR	0	1	0.140	0.488
Size	16.283	21.654	18.25	0.856
BoardSize	7	18	12.804	3.245
BoardIndep	0.154	0.9	0.548	0.166
ShareLoans	34.215	96.876	87.69	12.617
ShareFee	12.501	45.330	25.93	6.453
Unemployment	2.2	31.04	13.21	5.08

N = 160 (number of Italian financial institutions).  $\Sigma T_i N$  is the number of observations corresponding to each variable. The number of observations differs due to the presence of missing values. T-values of two-tailed t-statistic test of mean difference. Difference test is made assuming unequal variance in variables where the Levene test discards the homogeneity.

manage financial institutions are more risk unfriendly than their male colleagues. This finding also stands when applying CR as risk measure.

The negative relationship between gender diversity and risk-taking is also confirmed by the results when we contemplate the Z-score as a dependent variable. The coefficients regarding F\_CEO and F\_CFO are significantly positive (significance at 0.05 and 0.01 level respectively), which corroborating the hypothesis that financial institutions run by female executives are related to lesser insolvency risk.

To handle the endogeneity problem, we fitted the sample including only those financial institutions in which no replacements occurred during the sample period (i.e. the institutions have a male or female top manager for the total period of the analysis. The uses of a restricted sample with no changes in the top management positions provide a further check for the greater risk aversion of female top managers. Hence, these findings support the main estimations because financial institutions with a CEO, CFO or CHAIR modification over the period do not influence the results regarding the complete sample.

Additional estimations were implemented to have an extensive outlook of the relationship between gender diversity and risk. First, we re-form the estimates by inspecting subclasses of financial institutions by size to prove if the main results are verified for all sized institutions. The determinants of risk can change depending on size, consequently the influence of female top managers can change according to this variable. The size subsamples were constructed based on the median of average total assets for the entire time period. Financial institutions above the median size are classified as large institutions, while the remaining ones are ranked as small

institutions.

First, we detected the positive impact of female executives on capital adequacy in the both two sub-sample, with a considerably larger impact to CAR from F\_CFO in the large institutions. The effect on CR is detected for the large financial institutions only, demonstrating that F\_CEOs are more inclined to maintain a high capital adequacy compared to weighted risks, rather than as a simple leverage ratio. Likewise to the principal regression outcomes, gender diversity does not impact on credit and insolvency risks in both size subsamples. This finding proves that upper capital adequacy is not correlated to persistent difficulties on the credit portfolio side.

Second, we contemplate the possible role of the macroeconomic context. Local economic environment can distress the association between gender diversity and corporate risk-taking in several ways. Regions characterized by unemployment under the median are categorized as robust economies, while the residue regions constitute the feeble economy subsample. We re-assess the equation for the two subsamples according to the mean employment over the entire time period. On the one hand, findings show that risk aversion of financial institutions improved under poor economic conditions. On the other hand, men and women respond inversely when they face loan demands because of their diverse sensibility to poverty. The estimations show that risk-taking is not prejudiced by the local economic environment since female CEOs are incline to uphold obstinately higher capital adequacy in financial institutions situated both in healthy and feeble economies. These results attest that the capital buffer is not reserved to gap a lack of heftiness in local economic environments since female-led banks

**Table 3.** Correlation matrix.

Variable	CAR	CR	Z-score	NPLratio	LLPratio	F_CEO	F_CFO	F_CHAIR	Size	BoardSize	BoardIndep	ShareLoans	ShareFee	Unemployment
CAR	1.0000													
CR	0.8213*	1.0000												
Z-score	0.2023*	0.2241*	1.0000											
NPL	-0.069*	-0.1062*	-0.1627*	1.0000										
LLP	-0.0720*	-0.0517	-0.0889*	0.4743*	1.0000									
F_CEO	0.1892*	0.2123*	0.0832*	-0.0316	-0.0117	1.0000								
F_CFO	0.1995*	0.2135*	0.0852*	-0.0345	-0.0221	0.6287**	1.0000							
F_CHAIR	0.1878*	0.2114*	0.0832*	-0.0317	-0.0117	0.6363**	0.5323*	1.0000						
Size	-0.6645*	-0.7367*	-0.1845*	0.2282*	0.1432*	-0.2036*	-0.2852*	-0.2036*	1.0000					
BoardSize	-0.0248	-0.0365	0.2074**	-0.1389	0.1343	-0.0923	-0.0845	-0.0914	-0.1483	1.0000				
BoardIndep	0.2677	0.1078	-0.2349	0.0188	-0.1944*	0.3278*	0.3427*	0.3519*	0.1445	0.2892*	1.0000			
ShareLoans	0.0050	0.0833*	0.0023	-0.1234*	-0.1344*	-0.0117	-0.0440	-0.0116	-0.0562*	-0.1156	-0.0689	1.0000		
ShareFee	-0.0633*	-0.1436*	-0.0585	-0.0386	-0.1073*	-0.0465	-0.1793*	-0.1067*	-0.0201	-0.1448	-0.0834	-0.1624*	1.0000	
Unemployment	0.0385	0.0792*	0.0166	-0.1581*	-0.0505	-0.0631*	-0.0942*	-0.0635*	-0.0973*	-0.1578	0.2492	0.0943*	0.1565*	1.0000

\*, \*\*, and \*\*\* represents the level of significance at the 0.10, 0.05 and 0.01 levels, respectively.

**Table 4.** The effect of gender diversity variables on risk-taking: main estimations.

	CAR	CR	Z-score	NPL ratio	LLP ratio
F_CEO	0.8243***(0.465)	0.0683***(0.277)	0.0365**(0.099)	0.0133(0.276)	0.0179(0.047)
F_CFO	1.2243***(0.477)	0.6644***(0.275)	0.1597***(0.096)	0.3144(0.278)	0.0249(0.046)
F_CHAIR	1.5853*(0.599)(0.024)	0.8883*(0.239)(0.007)	0.1094(0.072)(0.005)	0.3955(0.359)(0.0016)	0.0295*(0.031)(0.002)
Size	-5.6272***	-3.7449***	-0.1663***	1.7792***	0.0975***
BoardSize	0.0207(0.391) 0.024	-0.0333(0.227)	0.147*(0.040) (0.208)	0.0143**(0.233) (0.016)	0.0157*(0.017) (0.018)
BoardIndep	0.0311(0.032)	-0.0342(0.186)	0.164**(0.217)	0.017*(0.023)	0.0175*(0.022)
ShareLoans	0.098(0.032)	-0.0556*(0.013)	-0.0488*(0.007)	-0.0167(0.066)	-0.0373(0.008)
ShareFee	0.0054(0.0425)	-0.0962*** (0.011)	-0.0252***(0.009)	-0.0078(0.035)	-0.0123***(0.004)
Unemployment	0.1717***(0.043)	0.1287***(0.026)	0.0064 (0.008)	0.0377(0.043)	0.0077* (0.006)
Intercept	115.2088***	80.9975***	7.4754***	-28.8105***	-1.4033***
R-squared	0.4224	0.5573	0.0368	0.0446	0.0262

Panel fixed effects (within) estimation (significant Hausman test); Bank-level clustered robust standard errors are in brackets.

\*, \*\*, and \*\*\* represents the level of significance at the 0.10, 0.05 and 0.01 levels, respectively. Standard errors are in brackets.

display considerably higher levels of CAR and CR. Once more, credit risk is an unrelated variable in

counting capital amounts, as neither the NPL ratio nor the LLP ratio shows a statistically significant

coefficient for F\_CEO, F\_CFO and F\_CHAIR. Both sets of data are not presented in a specific

**Table 5.** Robustness checks.

	CAR	CR	Z-score	NPL ratio	LLP ratio
F_CEO	0.8167***(0.468)	0.0673***(0.254)	0.0379**(0.086)	0.0145(0.288)	0.0191(0.058)
F_CFO	1.2223***(0.492)	0.8762*** (0.253)	0.1573*** (0.082)	0.3194(0.287)	0.0223(0.039)
F_CHAIR	1.5997*(0.576)	0.6345*(0.233)	0.1095(0.072)	0.3877(0.387)	0.0369(0.037)
ShareDeposits	-0.0098	0.0170	-0.009	-0.0074	-0.0078***
Control variables	Yes	Yes	Yes	Yes	Yes
R-squared	0.4366	0.5553	0.0366	0.0478	0.0392
F_CEO	0.8213***(0.489)	0.0693*** (0.284)	0.0379**(0.082)	0.0169(0.246)	0.0155(0.075)
F_CFO	1.2342***(0.479)	0.8893***(0.285)	0.1564**(0.058)	0.3133(0.271)	0.0214(0.037)
F_CHAIR	1.6118***(0.598)	0.6447***(0.228)	0.1119*(0.080)	0.4107(0.376)	0.0289(0.032)
Per-capita Income	-0.0462**	0.0645***	0.0093	-0.0520*	-0.0022
Control variables	Yes	Yes	Yes	Yes	Yes
R-squared	0.4382	0.5579	0.0374	0.0392	0.0266

Panel fixed effects (within) estimation (significant Hausman test); Bank-level clustered robust standard errors are in brackets. \*, \*\*, and \*\*\* represents the level of significance at the 0.10, 0.05 and 0.01 levels, respectively.

table to save space in the paper. In order to check the robustness of the results, we also re-estimate the main model by including two different variables. Table 5 shows these estimates.

First, we comprise the deposits to assets ratio as an explanatory variable. Specifically, this variable can be intended as an important control variable as it represents the set of assets. Since various studies validated this ratio as a measure of corporate risk, we decide to include this ratio in order to test the main estimations. We attain the same results: especially F\_CEO and F\_CFO are significantly positive when explaining CAR and CR, while they are not important for both credit risk measures. Second, we take into consideration the pre-capita income in the local economy and we define it as the amount of registered income in the region where the financial institution is headquartered. The aim is to comprise an added variable regarding the local economic environment as well as for the companies' financial situation in

every district. The main findings are confirmed for CAR and CR.

### Conclusion

In this paper we investigated how gender diversity impacts on risk-taking of financial institutions in Italy. More specifically, we examined the effect of female top managers' behaviors on risk that we captured by five different risk proxies. In the past decade, the relation between board gender diversity and firm performance has gained considerable attention from numerous scholars, but the association between female executives and risk-taking in financial institutions was unclear yet.

The analysis reveals that there is a negative and significant association between the gender of persons in top managerial positions and the risk profile of the financial institutions. In particular, the

results confirm that Italian financial institutions led by female executives show a reliably high amount of capital, identified by capital adequacy (CAR) and the equity to asset ratio (CR). The economic impact of gender on capital ratios (CAR and CR) is positive and statistically significant particularly for F\_CEO and F\_CFO. The high capital amount does not initiate from minor asset quality, as no variance is detected for credit risk variables between male-run and female-run financial institutions. The suggestion on the greater risk aversion of female executives develops the understanding of risk-taking behavior in financial institutions. It also offers some political suggestions for regulatory authorities within the financial sector. Actions employed to restrict extreme risk-taking behavior of financial institutions should not be limited to capital requirements in order to avoid moral hazard behavior. In this regard, the effort ended by political bodies to encourage parity between women and men in top managerial positions of

listed companies and financial institutions proved to be beneficial since the attendance of female directors on boards may contain corporate risk-taking. Hence, regulators could steer the corporate governance of financial institutions by promoting participation of women in corporate bodies. Nevertheless, the only provision of a quota for women is not sufficient. The prominence should be on the selection of women with managerial experience and qualifications on board of directors. The regression analysis in fact demonstrates that the attendance of women in top managerial positions influences negatively the risk profile of the institution since female CEOs, CFOs and CHAIRs tend to take more conservative risk strategies because they choose a cautious attitude to face risky decisions than their male colleagues, in line with Perryman et al. (2016).

This paper aims to bridge the research gap concerning gender diversity in Italian financial sector. In particular, the existing literature shows little empirical evidence converging on the impact of gender diversity on corporate risk-taking in financial sector and the limited studies that explored this topic focused mostly on the influence of CEO gender. Moreover, no study examines this issue in Italian financial industry. Therefore, this study contributes in several ways to the existing literature on how the attendance of women in top managerial positions could impact on corporate risk-taking. Results confirm prior studies by proposing that gender differences in risk appetite and risk tolerance can have significant consequences for business decision-making and governance. Overall, the results recognized that female executives may essentially encourage less risky financial decisions and more conservative strategies, in line with the supervisors' interests. We believe that the effects of gender diversity on risk profile may have significant consequences for regulators, financial supervisors, depositors and other stakeholders. We can also endorse that the attendance of women in high managerial positions could have a significant impact in gaining a stable financial system eluding the disorder that can be spread to the real economy. Regulators will be able to further reduce corporate riskiness through more regulations about gender diversification. From a public political perspective, the accepted welfares of female leadership for financial stability may be of interest of regulators in setting future policies for stimulating gender equality and the progression of women in business. In general, the progression of women in financial industry may be consistent with the main supervisors' interests since gender diversity may encompass useful complementary information for assessing the security of financial institutions.

Results must be placed in relation with the limitations of the study. Firstly, although the findings show that female top managers influence risk-taking, this does not imply that only gender diversity does matter at all. As exposed by Adams and Ferreira (2009), the influence of gender diversity in management positions depends on the setting

of the firm's internal corporate governance. Precisely, female CEOs and Board Chairpersons may growth the risk checking ability of boardrooms and thus act as an extra control mechanism in companies with fragile governance structures (Nguyen et al., 2015). Hence, it is remarkable to inspect whether the impact of board gender diversity on corporate risk-taking may be existing in firms characterized by less developed corporate governance structures. This is an interesting starting point for future research.

Secondly, this research did not observe gender diversity by female top managers' education and demographic characteristics. Would the same or similar findings be found in different gender diversity specifications of top managers? Hence, future research could examine the influence of female management on bank risk profile by these classifications. Another potential restraint concerns the geographical location of the analysis. Would similar results be appreciated in other countries, either developed or developing? Although additional research needs to be done in a developing financial sector where very little is acknowledged about governance structure and its effect on risk profile, this research represents anyway an opportunity for women to progress into the business elite, for financial institutions to improve gender diversity in corporate governance, and for politicians looking for political measures that promote gender diversity in European financial institutions' boards.

## CONFLICT OF INTERESTS

The authors have not declared any conflict of interests.

## REFERENCES

- Adams RB, Ferreira D (2004). Gender diversity in the boardroom. European Corporate Governance Institute, Finance Working paper. P 30.
- Adams RB, Ferreira D (2009). Women in the boardroom and their impact on governance and performance. *Journal of Financial Economics* 94(2):291-309.
- Adams RB, Funk P (2012). Beyond the glass ceiling: Does Gender Matter? *Management Science* 58(2):219-235.
- Agnew J, Balduzzi P, Sunden A (2003). Portfolio choice and trading in a large 410(k) Plan. *American Economic Review* 93(1):193-215.
- Agoraki M-EK, Delis MD, Staikouras PK (2011). The effect of board size and composition on bank efficiency. *International Journal of Banking, Accounting and Finance* 2(4):357-386.
- Altunbas Y, Gambacorta L, Marques-Ibanez D (2012). Do bank characteristics influence the effect of monetary policy on bank risk? *Economics Letters* 117(1):220-222.
- Anginer D, Demircuc-Kunt A, Zhu M (2014). How does competition affect bank systemic risk? *Journal of Financial Intermediation* 23(1):1-26.
- Atkinson SM, Boyce Baird S, Frye MB (2003). Do Female Mutual Fund Managers Manage Differently? *The Journal of Financial Research* 26(1):1-18.
- Baltagi B (2001). *Econometric Analysis of Panel Data*, 2<sup>nd</sup> ed.. John Wiley and Sons, Chichester.
- Barber BM, Odean T (2001). Boys will be boys: gender, overconfidence, and common stock investment. *The Quarterly Journal of Economics* 116(1):261-292.

- Barua A, Davidson LF, Rama DV, Thiruvadi S (2010). CEO Gender and Accruals Quality. *Accounting Horizons* 24(1):25-39.
- Beck T, Behr P, Güttler A (2013). Gender and banking: are women better loan officers? *Review of Finance* 17(4):1279-1321.
- Bellucci A, Borisov A, Zazzaro A (2010). Do Male and Female Loan Officers Differ in Small Business Lending?. A Review of the Literature. MoFir Working Paper No. 47, December.
- Berger A, Klapper L, Turk-Ariss R (2009). Bank competition and financial stability. *Journal of Financial Services Research* 35(2):99-118.
- Berger AN, Kick T, Schaeck K (2014). Executive board composition and bank risk-taking. *Journal of Corporate Finance* 28(C):48-65.
- Burgess Z, Tharenou P (2002). Women Board Directors: Characteristics of the Few. *Journal of Business Ethics* 37(1):39-49.
- Byrnes JP, Miller DC, Schafer WD (1999). Gender Differences in Risk-Taking: A Meta-Analysis. *Psychological Bulletin* 125(3):367-383.
- Carter DA, Simkins BJ, Simpson WG (2003). Corporate Governance, Board Diversity, and Firm Value. *The Financial Review* 38(1):33-53.
- Charness G, Gneezy U (2012). Strong Evidence for Gender Differences in Risk-taking. *Journal of Economic Behavior and Organization* 83(1):50-58.
- Cosentino N, Montalto F, Donato C, Via A (2012). Gender diversity in the corporate boardroom: Do women affect risk? *Rivista di Politica Economica* 2:73-95.
- Croson R, Gneezy U (2009). Gender differences in preferences. *Journal of Economic Literature* 47(2):448-474.
- De Cabo RM, Gimeno R, Nieto MJ (2012). Gender Diversity on European Banks' Boards of Directors. *Journal of Business Ethics* 109(2):145-162.
- Dwyer PD, Gilkeson JH, List JA (2002). Gender differences in revealed risk-taking: evidence from mutual fund investors. *Economics Letters* 76(2):151-158.
- Elsaid E, Ursel ND (2011). CEO succession, gender and risk-taking. *Gender in Management* 26(7):499-512.
- Elsaid E (2014). Examining The Effect of Change In CEO Gender, Functional And Educational Background On Firm Performance And Risk. *Journal of Applied Business Research* 30(6):1605-1614.
- Faccio M, Marchica MT, Mura R (2016). CEO gender, corporate risk-taking, and the efficiency of capital allocation. *Journal of Corporate Finance* 39:193-209.
- Farrell K, Hersch P (2005). Additions to corporate boards: the effect of gender. *Journal of Corporate Finance* 11(1-2):85-106.
- Fehr-Duda H, de Gennaro M, Schubert R (2006). Gender, Financial Risk, and Probability Weights. *Theory and Decision* 60(2-3):283-313.
- Francis B, Hasan I, Wu Q, Yan M (2014). Are female CFOs less tax aggressive? Evidence from tax aggressiveness. *The Journal of the American Taxation Association* 36(2):171-202.
- Francis B, Hasan I, Park JC, Wu Q (2015). Gender differences in financial reporting decision making: evidence from accounting conservatism. *Contemporary Accounting Research* 32(3):1285-1318.
- Greene W (2004). The behaviour of the maximum likelihood estimator of limited dependent variable models in the presence of fixed effects. *The Econometrics Journal* 7(1):98-119.
- Huang J, Kisgen DJ (2013). Gender and corporate finance: Are male executives overconfident relative to female executives? *Journal of Financial Economics* 108(3):822-839.
- Jianakoplos NA, Bernasek A (1998). Are women more risk averse? *Economic Inquiry* 36(4):620-630.
- Krishnan GV, Parsons LM (2008). Getting to the Bottom Line: An Exploration of Gender and Earnings Quality. *Journal of Business Ethics* 78(1):65-76.
- Lepetit L, Strobel F (2015). Bank Insolvency Risk and Z-Score Measures: A Refinement. *Finance Research Letters* 13(C):214-224.
- Loukil N, Yousfi, O (2016). Does gender diversity on corporate boards increase risk-taking? *Canadian Journal of Administrative Science* 33(1):66-81.
- Nguyen T, Locke S, Reddy K (2015). Does boardroom gender diversity matter? Evidence from a transitional economy. *International Review of Economics and Finance* 37:184-202.
- Niederle M, Vesterlund L (2007). Do Women Shy Away From Competition? Do Men Compete Too Much? *The Quarterly Journal of Economics* 122(3):1067-1101.
- Palvia AA, Vähämaa E, Vähämaa S (2015). Are Female CEOs and Chairwomen More Conservative and Risk Averse? Evidence from the banking industry during the financial crisis. *Journal of Business Ethics* 131(3):577-594.
- Peni E (2014). CEO and Chairperson characteristics and firm performance. *Journal of Management and Governance* 18(1):185-205.
- Perryman AA, Fernando GD, Tripathy A (2016). Do gender differences persist? An examination of gender diversity on firm performance, risk, and executive compensation. *Journal of Business Research* 69(2):579-586.
- Powell GN, Butterfield DA (1994). Investigating the "Glass Ceiling" Phenomenon: An empirical study of actual promotions to top management. *The Academy of Management Journal* 37(1):68-86.
- Sarin R, Wieland A (2016). Risk aversion for decisions under uncertainty: Are there gender differences? *Journal of Behavioral and Experimental Economics* 60:1-8.
- Schaeck K, Cihák M (2012). Banking Competition and Capital Ratios. *European Financial Management* 18(5):836-866.
- Sghaier A, Hamza T (2018). Does boardroom gender diversity affect the risk profile of acquiring banks?. *Managerial Finance* 44(10):1174-1199.
- Sila V, Gonzalez A, Hagendorff J (2016). Women on board: Does boardroom gender diversity affect firm risk? *Journal of Corporate Finance* 36(C):26-53.
- Skala D, Weill L (2018). Does CEO gender matter for bank risk? *Economic Systems* 42(1):64-74.
- Sundén AE, Surette BJ (1998). Gender differences in the allocation of assets in retirement savings plans. *American Economic Review* 88(2):207-211.
- Watson J, McNaughton M (2007). Gender Differences in Risk Aversion and Expected Retirement Benefits. *Financial Analysts Journal* 63(4):52-62.
- Wu YW, Truong C (2014). Female Bank Executives: Impact on Performance and Risk-taking. Available at: [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2406492](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2406492)
- Yeyati EL, Micco A (2007). Concentration and foreign penetration in Latin American banking sectors: Impact on competition and risk. *Journal of Banking and Finance* 31(6):1633-1647.
- Zigraiova D (2015). Management Board Composition of Banking Institutions and Bank Risk-taking: the Case of the Czech Republic. CNB WP 14/2015, Czech National. Available at: <https://www.econstor.eu/handle/10419/174169>

*Review*

# **Social responsibility practices of leading firms in an industry: Driver for corporate citizenship in Kenya**

**Fredrick Onyango Ogola**

Strathmore University Business School, P. O. Box 59857, Kenya.

Received 15 June, 2020; Accepted 14 September, 2020

The study examines the relationship between the Corporate Citizenship (CC) practices of leading firms in their industries and their level of advancement in CC. The study took a conceptual approach and used two cases not as empirical evidence but for illustration purposes. The main hypothesis was that CC practices of leading firms find expression from the fact that these firms tend to play two significant roles. First, leading firms in CC can set standards (pace-setting) of CC practice in their industry which would become a benchmark for other firms. Second, leading firms take up the challenge to catch up with the standards set by other firms in the industry in other aspects of CC where they are not leaders. The results show that the two cases used by the study have revealed how the CC practices of a leading firm in an industry under institutional isomorphism that manifests through pace setting and catching-up can improve the general CC practices of an industry. As a practical recommendation, champions of CC like NGOs should target leading firms more as their practices are more likely to be replicated by other firms in the industry since the study has demonstrated that firms in the industry tend to copy leaders (innovators and early adopters) more than laggards.

**Key words:** Corporate social responsibility, corporate citizenship, socially responsible behaviour of leading firms, institutional isomorphism.

## **INTRODUCTION**

A newcomer in the field of business and social issues would be bewildered by a number of different terms and definitions that imply similar or identical meaning such as Corporate Social Responsibility (CSR), Business Ethics, Corporate Philanthropy, Corporate Citizenship (CC) among other terms (Valor, 2005). In that regard, the current study uses the terms CC which other authors could refer to as CSR.

CC has received increased attention from business, the media, and researchers (Valor, 2005). Yet CC like most of the terms in management is yet to receive a widely

acceptable definition (Othman and Othman, 2014). As a result, we do not pretend to define what CC is since there is no generally accepted definition or even the most appropriate one. Nevertheless, the current study takes the definition of policy.

Policy makers define CC as a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis. In this concept, CC is viewed as the contribution that firms make to sustainable development, requiring them to commit to

E-mail: [fogola@strathmore.edu](mailto:fogola@strathmore.edu).

Author(s) agree that this article remain permanently open access under the terms of the [Creative Commons Attribution License 4.0 International License](https://creativecommons.org/licenses/by/4.0/)

balancing and improving environmental and social impacts without damaging economic performance (Williamson et al., 2006). In recent years, the concept of corporate social responsibility, which for the sake of this study is referred to as CC, has gained recognition and importance in both business and political settings. Social responsibility in Africa is something that is yet to take root to match what is already happening in Europe, North America and some parts of Asia and is still seen in terms of philanthropy (Ofori and Debrah, 2014).

This raises an important question: 'what can drive social responsibility practices in Africa? This question is worth exploring since African business environment is so different from that in the western countries. There is not much movement of ethical consumers as seen in Germany which is evident in the shell case of trying to sink the Brent spar into the northern sea (Greyser and Klein, 1996). Consumers are still more driven by affordability (due to low purchasing power) and accessibility (due to poor distribution infrastructure, transportation logistics); and less by acceptability (ethical practice of firms). However, there is emergence of sustainability reporting in Africa, as Ernst and Young report that it has several drivers. These include a move by a range of stakeholders driving organizations to implement a more sustainable strategy; sustainability decision-making is moving to the board, the drivers and benefits of sustainability reporting are increasing in prominence. However, the same reports explicate that the responsibility for preparing sustainability report is not yet completely aligned with the strategic or executive function of corporate Africa. This leads to a basic question that is instrumental to the African context of CC: 'what is driving CC that has led to its continued growth in importance and significance among academics and corporate Africa?' This question is critical since the study opines that there are three key broad drivers of CC, that is business case, institutional drivers and managerial values.

This paper extends the institutional theory of CC by positing that one of the forces behind the continued growth in significance of CC among academics and business communities can also be associated with the CC practices of leading firms in their respective industries. This is what this study opines is one of the key drivers of CC in Africa in general and Kenya in particular. CC practices of leading firms CC are particularly appropriate given the fact that both state regulation and industry-self regulation could be necessary but not sufficient. In fact, many researchers have argued that corporations may not only resist the imposition of regulations by the state in the first place but may also seek to control or otherwise capture regulators in ways that bend them toward the will of the corporations they are supposed to oversee (Etzioni, 1989.; Bernstein, 2015; Vogel, 1989; Tolbert and Zucker, 1983). This is probable in Africa where some corporates are almost more

powerful than the state as most of them in power have captured the institutions in these countries due to economic power. This means they own the largest corporations in the country where they are the head of state. Moreover, the very corporations can also undermine effective self-regulation. For instance, there are plenty of examples of corporations violating cartel agreements (Fama and Jensen, 1983) or refusing to abide by industrial benchmarks and standards for quality that have been set by industrial associations. A scandal in the U.S. accounting industry-an industry that has long set its own standards of acceptable business practice-is another example of industrial self-regulation gone awry. Moreover, according to Campbell (2007), some instances of industrial self-regulation have been devised not only to evade state regulation and other forms of external control but also to facilitate predatory and opportunistic rather than socially responsible corporate behavior. That is why the social responsibility of the leading firms in an industry could set precedence that would fill the gaps left by business case, state regulation as well as managerial values exuded by self-regulation.

## LITERATURE REVIEW

In the extant literature, one of the basic questions about CC is: why does CC continue to grow in importance and significance among academics and business communities? In response to this question, some empirical studies with the aim to make a Business Case (BC) for CC have examined the relation between CC and corporate financial performance (CFP). The BC for CC refers to the rationale for the business community to advance the CC 'cause'. The BC refers to the bottom-line reasons for pursuing CC strategies and policies (Othman and Othman, 2014).

BC has investigated the relation between CC and corporate financial performance (Argenti, 2004; Gray and Balmer, 1998; Lee, 2008; MSteger, 2006; Schwaiger, 2004; Vagadia, 2012; Wagner and Schaltegger, 2004; Margolis and Walsh, 2003; Weber, 2008). BC led to the belief by these management disciplines that CC is fit for their business (Lee, 2008). Business case has not successfully demonstrated itself as a driver of CC. Empirical research aimed at proving that there is a positive relationship between Corporate Social Performance (CSP) and CFP has inconclusive results. These CSP-CFP studies have ended up with inconclusive results (Roman et al., 1999, Baron, 2010). One category shows a positive link between CSP and CFP, the second shows a negative link, and the third shows no link.

With regard to MVs, research has shown that the formal adoption and implementation of CC by corporations can also be associated with socially conscious values of organizational managers (Hemingway and Maclagan,

2004). This stream of research has empirically demonstrated that the cognitive frames, mind-sets, conceptions of control, or worldviews of corporate managers are important determinants of how managers run their firms (Aguilera and Jackson, 2003; Dore, 1983; Hall and Soskice, 2001; Whitley, 2004). At the institutional level, powerful social and political forces encourage organizations to act more responsibly (Campbell, 2007).

### ***The neglected institutional driver for CC***

Apart from the business case for CC, managerial values and institutional drivers for CC already mentioned, previous research has not yet considered the contribution that could be made by CC practices of firms that are leading in CC in their respective industries. Since the business case for CC is still not clear, managerial value for CC in Africa is at the infant stage, while there are weak institutions as found out by Ofori and Debrah (2014). The study explores what could be the drivers of CC in corporate Kenya. It is worth noting that leadership of a firm is referred to as perceived leadership by the firm's peers in the industry.

The contribution of CC practices of leading firms in an industry is likely to manifest in two ways. This is with regard to pace setting and catching-up. When a firm generally leads in CC, it sets the pace in most of the aspects by setting the industry standards that other firms strive to achieve and in the process the CC practices of the industry advance. On the other hand, since the firms that lead in overall CC performance are very unlikely to lead in all CC aspects, they push for being leaders and they need to keep their leadership position to catch-up with other firms. And in the process the CC practices of the entire industry are likely to advance. Following the same line of thought, Snider et al. (2003) noted that the most effective means of advancing CC is through corporate peer pressure. Industrial associations, whose job, in part, is to ensure that their members act in socially responsible ways often undertake this. To better formulate this contribution, we shall borrow a leaf from New Institutional Organizations literature under institutional isomorphism theory proposed by DiMaggio and Powell (1983) and Greenwood and Meyer (2008) which form the core of the theoretical framework of the study.

## **THEORETICAL FRAMEWORK OF THE STUDY**

Here, first the term institution is defined. Next, an institutional isomorphism theory of CC and the insights of CC of a leading firm in an industry as a CC driver are presented. The institutional isomorphism theory describes the conceptual understanding of how CC practices of leading firms in an industry through pace-

setting and catching-up could advance CC practices. Institutions, by North's definition, are the basic rules of the road in an economy, including formal systems, such as constitutions, laws, taxation, insurance, and market regulations, as well as informal norms of behavior, such as habits, customs, and ideologies (North, 2004). According to North (2004), institutions are both formal and informal. Formal institutions are rules and regulations that are devised by human beings to achieve a certain goal. Informal institutions are conventions and codes of behavior (North, 2004).

Unfortunately, "We cannot see, feel, touch or even measure institutions; they are constructs of the human mind". Nevertheless, institutions have power (North, 2004: 107). In fact, institutional forces determine what organizations come into existence, remain in existence and how they evolve (North, 2004).

### **Institutional isomorphism theory of CC**

Institutional isomorphism is "the constraining processes that force one unit in a population to resemble other units that face the same set of environmental conditions" (DiMaggio and Powell, 1983). In their attempt to answer why organizations are very much the same in their effort to change themselves, DiMaggio and Powell (1983) found out that it is due to isomorphism mechanisms that take place through coercive, mimetic and normative processes. The three mechanisms of institutional isomorphism are explained below.

#### **Coercive isomorphism**

Coercive isomorphism results from both formal and informal pressures exerted on an organization by other organizations upon which they share the same industry. In fact, one of the foundational tenets of institutional theory is that in order to prosper, organizations must be congruent with their institutional environments (Meyer and Rowan, 1977; Meyer and Scott, 1983), their structures and services must align with the "cultural-cognitive belief systems and regulatory and normative structures that prevail in a given organizational community" (Baum and Rao, 2004). Organizations are forced into such alignment because it promotes their success and survival by increasing the commitment of internal and external constituents of organizations and activities, and allowing them to obtain resources (Meyer and Rowan, 1977; Stinchcombe, 1965).

These formal pressures from regulators and informal pressures from some firms in the industry (mostly the leading firms) enhance the institutionalization of an industry. Institutionalization of an industry refers to the adoption of certain practices by firms in an industry due to the informal and formal institutional pressures they face. Institutional pressures could be felt as a force,

persuasion, or as invitation to compliance.

### Mimetic isomorphism

Mimetic isomorphism is due to the fact that uncertainty is also a powerful force that determines the behavior of organizations. This is so because when organizational technological environment is uncertain (March and Olsen, 1976) when goals are ambiguous, or when the environment creates symbolic uncertainty, organizations may model themselves on other organizations. This is because these organizations face the challenge of gaining acceptance (Suchman, 1995). This happens when, upon embarking on a new line of activity, particularly one with few precedents elsewhere in the social order, organizations often face the daunting task of winning acceptance either for the propriety of their activity in general or for their own validity as practitioners. This "liability of newness" (Freeman et al., 1983; Stinchcombe, 1965) manifests itself when new operations are technically problematic or poorly institutionalized; early entrants must devote a substantial amount of energy in sector building. For instance, in the Mobile money case, there were some uncertainties with regard to regulation and best practices in the industry. This level of uncertainty pushed other firms in the industry to model themselves on Safaricom, the leading firm by customer base and also subscriber base for mobile money.

### Normative isomorphism

Normative isomorphism stems primarily from professionalization. Organizations may hire staff from a particular institution due to the perception that staff trained from the institution has greater chances to perform well. In that regard, "the greater the reliance on academic credentials in choosing managerial and staff personnel, the greater the extent to which an organization will become like other organizations in its field" (DiMaggio and Powell, 1983). Moreover, "the greater the participation of organizational managers in trade and professional associations, the more likely the organization will be, or become like other organizations in its field" (DiMaggio and Powell, 1983). The theoretical background has now set the stage for illustrating the role of leading firms as a CC driver.

### The role of leading firms as a CC driver

As stated earlier, a leading firm in an industry plays an important role in the institutionalization of the industry since it sets the norms, standards and codes of conduct. These norms, standards and codes of conduct manifested through coercive isomorphism become informal and formal pressures that face every firm that shares the

industry with the leading firm. The pressure is even higher when there is some level of interdependence in the industry. The leading firms also set the socio-cultural expectations in which organizations that it shares the industry with are likely to operate.

Once a leading firm defined the norms and set standards of what is considered CC best practices in an industry, other firms in the industry may replicate the practices of the leading firm in order to survive and gain legitimacy (Suchman, 1995), which, in this study simply means gaining acceptance. There are several strategies for gaining legitimacy: (a) efforts to conform to the dictates of preexisting audiences within the organization's current environment, (b) efforts to select among multiple environments in pursuit of an audience that will support current practices, and (c) efforts to manipulate environmental structure by creating new audiences and new legitimating beliefs. The firms in the industry being studied seem to pursue their legitimacy, in the context of institutional isomorphism, through strategy (a).

According to the argument of natural selection in population ecology, for an organization to be considered fit, it must have an evolutionary process of adaptation that ensures that only the best-performing organizations survive (Whetten and Aldrich, 1979; Comstock, 1979; Hannan and Freeman, 1977; McKelvey, 1982). The replication of the CC of leading firms in an industry in order for them to survive leads to advancement in CC depending on how socially responsible the leading firm is. Suppose, the leading firm is a social icon, firm with exemplary practices, it becomes a pace-setter, mechanism in CC advancement.

Uncertainty with regard to the management of corporate image or reputation in CC is an interesting phenomenon. It is what fosters mimetic isomorphism in CC strategy. As stated earlier, uncertainty is a powerful force because when the business environment is uncertain, organizations may model themselves on other organizations. Since there is a lot of pressure on organizations to practice CC, for instance, while the BC for CC has not yielded conclusive results on whether there is a positive relationship between CC and CFP, there is uncertainty on the business leaders since they cannot be sure of the benefits they can get from CC. In Africa it is even more difficult to find a relationship between CSP and CFP since there is still no significant number of ethical consumers. However, there is no business that can be perceived as socially irresponsible if what Nike<sup>1</sup> and Shell<sup>2</sup> went through are anything to go by.

<sup>1</sup> . Nike was accused of using child labor in the production of its soccer balls in Pakistan and this led to customer boycotts especially Fifa, one of their main customers which forced the company to undergo through significant turnaround in cleansing its name then being among the leading firms in CSR in the industry through the push from "not **Just do it** but **Do it right**." This can be seen further on <http://www1.american.edu/tes/nike.htm> and <http://www.prwatch.org/node/6131> both accessed on 21st January 2011.

<sup>2</sup> . Brent Spar, was a North Sea oil storage and tanker loading buoy in the Brent oilfield, operated by Shell UK. With the completion of a pipeline connection to

In that regard, firms might be forced to adopt CC without being sure of its contribution to the profitability of the firm. This might make them practice what other players in the industry are doing in order not to be perceived as outliers in the industry. Assuming that this case exists in an industry, other firms in the industry are likely to turn to copying the CC practices of leading firms. Consequently, the CC practices of the leading firms in the industry will determine the behavior of other firms hence a driver for CC, at least in that industry.

Since normative isomorphism, as stated earlier, stems from professionalization, it can also be a driver for CC by professionalizing it in an industry. This can be the case whereby firms in a given industry tend to hire staff from a particular academic institution. In such industries, the greater the reliance on academic credentials in staff selection, the greater the chances and extent to which an organization becomes like other organizations in this field. Since people are more inclined to replicate best practices, the dominant influence will come from the practices of the leading firms in the industry. In the case of CC, professionals hired in a given firm will tend to copy their colleagues whom they have a similar organizational schemas or cognitive framework by virtue of their academic formation in the same institution on how to make their firms socially responsible in a fashion that makes business sense. This could be due to the assumptions that the managers of the leading firms could be mentors or role models to the managers of other firms in the industry. Moreover, the greater the participation of organizational managers in trade and professional associations such as Business Marketing Associations (BMA)<sup>3</sup> and Association of Finance Professionals (AFP)<sup>4</sup>, as stated earlier, the more likely the organizations will be like other organizations in the same industry. This is due to the mentoring roles of managers that head the leading firms in that industry as their counterparts see them as role models and innovators in the industry. The underlying idea is that managers seek to act in ways that are deemed appropriate by other managers and significant actors in their environment (Campbell, 2007). The above discussion leads to a framework that can be used to describe CC practices of leading firms in their respective industries as a driver for CC (Figure 1).

### Two cases illustrating how the behavior of leading firms can be a CSR driver

Two cases of firms that lead in CC in their respective

---

the oil terminal at Sullom Voe in Shetland, the storage facility had continued in use but was considered to be of no further value as of 1991. Greenpeace organized a worldwide, high profile media campaign against this plan. [http://www-static.shell.com/static/gbr/downloads/e\\_and\\_p/brent\\_spar\\_dossier.pdf](http://www-static.shell.com/static/gbr/downloads/e_and_p/brent_spar_dossier.pdf), accessed on 21 January 2011.

<sup>3</sup>. <http://www.marketing.org/i4a/pages/index.cfm?pageid=1>, January 21, 2011.

<sup>4</sup>. <http://www.afponline.org/>- January 21, 2011.

industries are presented here. The first case is EABL's social innovation followed by M-Pesa (Mobile-Money) innovation by Safaricom, a leading Mobile Network Provider (MNP) in Kenya.

### Corporate social innovation in East African Breweries Limited

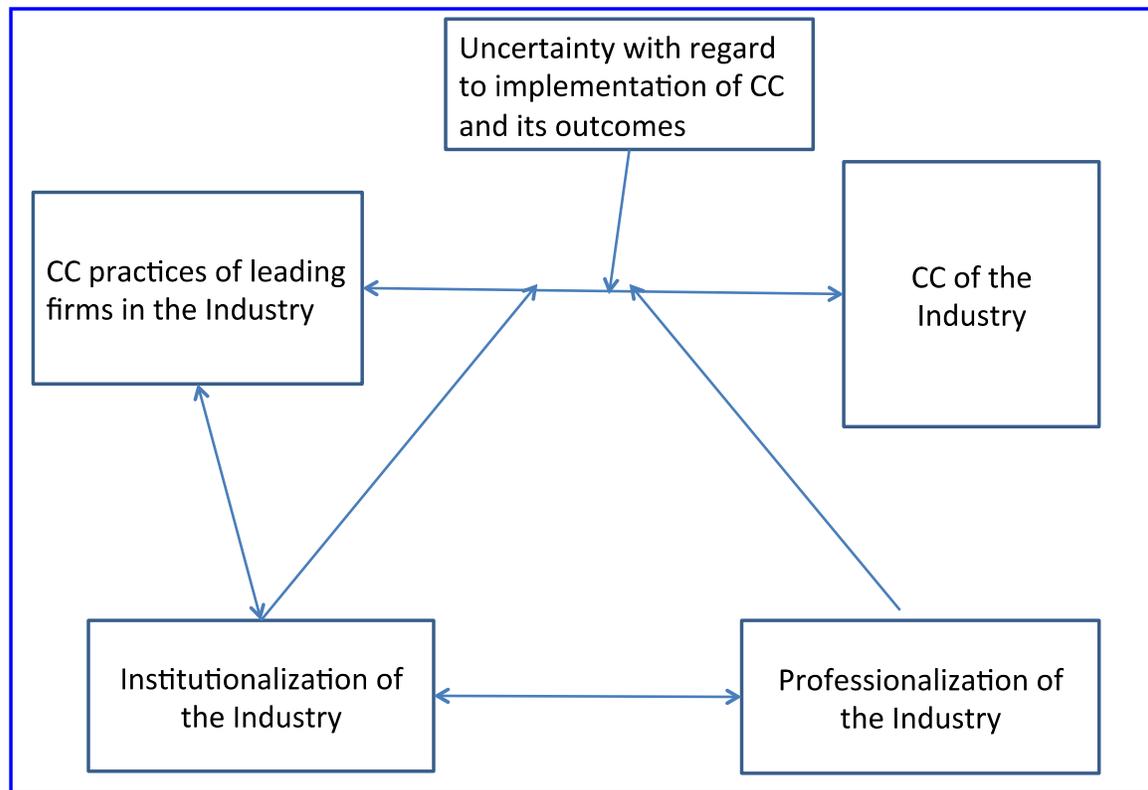
Between 1998 and 1999, about 500 Kenyans died from adverse effects of illicit liquors<sup>5</sup>, according to local media. Additionally, in November 19, 2000, the East African Standard reported that the death toll from the consumption of an illicit brew in the slums of Nairobi hit 132, with fears that the figure could rise as more people were hospitalized. Around the same time, The People Daily reported that at least 20 people had lost their sight, a story that was confirmed by the national referral hospital, Kenyatta National Hospital (KNH). These increasing rates of alcohol mortality and poisoning prompted EABL, the largest player in the beer market, to explore and assess ways of responding to this social predicament.

In December 2003, EABL launched a low-cost beer named Senator targeted at low-income consumers in Kenya. The decision was based on the realization that a significant portion of Kenyan alcohol market was divided between traditional brews<sup>6</sup> and illicit liquors. These brews and liquors were leaving behind a trail of health problems on their consumers. Senator was targeted at the bottom of the pyramid (BOP) consumers. Despite being the market leader with a 95% market share in the branded beer market, EABL only held 44% of Kenya's overall alcohol consumption. The rest of the market comprised non-branded alcohol products most of which were illegally produced and sold mainly to BOP consumers. But since the competitors (illicit liquor) for this socially responsible product (Senator) were charging very low prices it became very difficult for Senator Project to be economically viable for EABL. In fact in an effort to make it sustainable, EABL exhausted all its possible VAT tax concessions. The only option left for negotiation with the government was a reduction or waiver of excise duty on Senator. This entailed working in collaboration with several government departments and ministries among other players, for instance, the Kenya Revenue Authority (KRA), Ministry of Health, Ministry of Local Government, Kenya Association of Manufacturers (KAM) and Kenya Bureau of Standards (KEBS) among other stakeholders. KAM, in which most of the managers of EABL belong, was able to remind their colleagues of their social responsibility as the leading beer brewer in Eastern Africa.

---

<sup>5</sup>. Illegally produced alcohol that are presumed dangerous due to the unhygienic production conditions

<sup>6</sup>. Brews which are mainly used for cultural purposes such as birth, initiation, marriage and funeral ceremonies



**Figure 1.** Framework to understand CSR practices of leading firms in an industry as a driver for CC. Source: Author's elaboration.

EABL presented a case to the government for a waiver of excise duty on Senator. The thrust of EABL's argument was that the government would save on the taxpayers' money by reducing the resources used in dealing with illnesses and emergencies created by the consumption of illicit brews. Moreover, the government would start collecting some of the tax that was being lost from the sale of illicit brews – this category of drinks comprised 56% of the alcohol market in Kenya. KRA assessed the case and recommended that the request be granted. In late 2004, the government agreed to a 30% concession on excise duty tax on Senator rather than a total exemption. The concession was available to any non-malted beer manufacturer in Kenya. EABL, with regard to manufacturing process, was innovative turning Senator into a non-malt beer (brewed from barley) since malt beer attracts higher taxation from the government compared to non-malt beer. This made senator beer the world's barley only brewing process. This reward opened the doors for other beer companies that wanted to replicate the production strategy of EABL, this time without having to spend time and resources in negotiating with the government on tax concessions and also experimenting. This incentive acted as a driver for more innovation in this direction hence enhancing the CC of the beer industry in Kenya as the alcohol related

problems continued to diminish. Kenya moved from a drinking nation to a working nation.

Upon the lessons the government learnt from the social innovation of EABL, the government sponsored a bill in parliament to allow other alcohol companies to follow what EABL had done and at the same time to have more stringent rules to avert deaths caused by consumption of illicit brews. Among the companies that now follow a similar business model as EABL is Keroche Industries, which is among the fiercest competitor of EABL (See the case: Keroche Industries Take on Market Giant EABL)<sup>7</sup>. This is a healthy competition, caused by the behavior of EABL in the industry, and it improved the social responsibility of companies in the beer industry in Kenya as endorsed by the Ministry of Health.

### **M-PESA-Kenya's Experiment with Branchless banking**

M-PESA is a mobile payment solution provided by Safaricom, Kenya's leading MNP. M-PESA facilitates a variety of financial transactions, including deposits,

<sup>7</sup> . <http://www.ratio-magazine.com/20080813127/News-Analysis/Keroche-Industries-Take-on-Market-Giant-EABL.html>

withdrawals, money transfers, loan payments, and bill payments through mobile phone and a network of agents that included airtime resellers and retail outlets acting as 'banking agents'. The M-PESA service does not require users to have bank accounts. M-PESA, thus, served as a branchless banking service for Millions of Kenyans who did not have access to banking services. Since its introduction in March 2007, M-PESA had shown exceptional growth, with six Million customers having registered for the service, which were nearly half the customer base of Safaricom and an average of daily transaction volume of \$ 1.96 million.

According to the judges of GSMA Global Awards 2009<sup>8</sup>, M-PESA is:

*"An accessible and intuitive solution, reflected by an unprecedented take-up rate for a service of this kind; M-PESA will serve as a blueprint for other operators around the world. Targeting the unbanked, this provides a simple means for people to safely transfer and carry money."*

This service was so innovative that it penetrated beyond microfinance. Microfinance had expanded the reach of financial services to the poor, the unbanked and the people in remote areas. Yet a vast segment of the populations remained outside the net of microfinance, primarily because of the transaction costs involved in serving them. A novel concept, 'branchless banking'<sup>9</sup> had thus emerged as one of the solutions to address this social problem (Appendix 1).

After close to two years of rapid and sustained growth (Appendix 2), there was the phase whereby lack of appropriate regulatory status-similar to that of a bank-inhibited the growth of M-PESA. Moreover, some experts had questions as to why M-PESA had not fully developed into a savings product since a number of its customers used it as a savings avenue and the fact that it had reduced the percentage of the unbanked in Kenya (Appendix 3). They had pointed out several plus points of M-PESA that render it most suitable for offering savings products. One, the number of M-PESA agents in Kenya was about 11 times more than the number of bank branches. Two, the absence of a monthly or maintenance fee and free deposit transactions made M-PESA more affordable than most other savings products. Three, a number of customers regarded M-PESA as a safe mechanism for storing their savings.

M-PESA was also beginning to face competition with the entry of new players. A major operator Zain, now Airtel, had entered the market in February 2009 with its mobile money product under the brand name 'Zap', and

another mobile operator, Orange, was also planning to come out with its money transfer product<sup>10</sup>. Zap was marketed, more than just a mobile money service- it was promoted as "mobile wallet", which could enable customers transfer money between their zap wallet and bank account. The pricing of Zap was also competitive vis-à-vis M-PESA. Unlike M-PESA, Zap customers had a recommended fee structure which allowed them negotiate the actual transaction fee with agents. Zap grew as rapidly as M-PESA<sup>11</sup>. Safaricom responded by introducing other innovative products like M-Kesho, a money savings product and M-Shwari, which is just like a bank with an option for customers to access mobile loans and this trend continues. After over two years of rapid growth, M-PESA had some challenges at hand as it faced competition from other MNPs that replicated its strategy in the mobile money business segment.

As Safaricom continued to innovate to respond to the services needs of the Kenyan society, they realized more needs than innovative responses. This necessitated Safaricom, in partnership with Vodafone, to establish a training facility to build technological capacity to meet the needs of the fast-growing telecommunications industry, which lacks specialists with vital applications development skills for the economy.

## DISCUSSION

The two confirms our postulation that CC practices of leading firms is a driver for CC due to the fact that these firms tend to play two significant roles. First, EABL and Safaricom's M-PESA set standards (pace-setting) of CC practices in their industry which would be a benchmark for other firms. Second, the two firms have also taken up the challenge to catch up with the standards set by other firms in the industry in other aspects of CC where they do not command the lead. These two roles make the CC practices of leading firms a driver for CC in their respective industries but, as illustrated in Figure 1, they are contingent on the level of institutionalization of the industry. This leads to coercive isomorphism, the level of uncertainty in the industry that triggers mimetic isomorphism, and the level of professionalization of the industry that ignites normative isomorphism. We now discuss how each of the types of isomorphism is evident in the two cases.

### Coercive isomorphism

Coercive isomorphism was observed in both cases. Coercive, as already defined, results from both formal

<sup>8</sup> . It news, <http://www.itnewsafrika.com/2009/02/safaricom%e2%80%99s-m-pesa-service-wins-global-award/>

<sup>9</sup> . Branchless banking did away with the conventional (traditional) system of branches to serve populations in different geographic zones. It used information and communications technologies and network of non-bank retail agents to reach customers instead of the brick and mortar branch model.

<sup>10</sup> . <http://www.consumersinternational.org/media/165195/ourmoneyourrights-theevolutionoffinancialservicesinafrica.pdf> (accessed on April 13, 2011)

<sup>11</sup> . <http://www.consumersinternational.org/media/165195/ourmoneyourrights-theevolutionoffinancialservicesinafrica.pdf>

and informal pressures (norms) exerted on an organization by other organizations upon which they share the same industry; hence there is a level of interdependence among firms. With regard to social innovation at EABL, Senator Project can be categorized under 56% of the alcohol market that was unregulated. But after EABL produced the branded beer, Senator, other beer companies replicated EABL's strategy, which entailed going by the informal norms EABL had created in that market segment. Additionally, learning from the socially responsible behavior of EABL, the government sponsored a bill in parliament to formalize the informal norms already established by EABL pushing other firms to comply.

In the M-PESA case, as stated earlier, Safaricom's regulator (CCK) did not know how to regulate M-PESA. In fact, CCK, cautious that regulation could kill the innovation, left Safaricom to self-regulate while monitoring its behavior. During this period, the behavior of Safaricom with regard to M-PESA established the informal norms in the industry that were later replicated by new market entrants. The informal norms in the industry continued under the watch of the regulators who started formalizing some of the informal norms in the industry.

The other interesting aspect of coercive isomorphism came to play when Orange was to launch itself as a MNP. The management feared that since both Safaricom and Airtel, apart from being MNP also offer mobile money services, Orange would not be taken seriously should they not follow the norm, which is to include mobile money services in their business model. Yu, another MNP faced the same dilemma. In that regard, it is evident that the leading firms in the context of coercive isomorphism can produce a means through which CC practices can be enhanced. This can be in a semi-voluntary environment since leading firms impose informal norms upon themselves and upon the industry and their regulators can formalize them. Therefore, with regards to coercive isomorphism, the two cases illustrate how the behavior of the leading firm can affect the behavior of other firms in the industry of which if they were socially responsible it can lead to better CC practices of individual firms and consequently the CC of the entire industry. These informal means that later become formal means of institutionalizing socially responsible behavior could be more effective in developing countries than regulatory approach; which are actually being implemented in India with very little impact. In India companies are required to spend around 3% of their pre-tax profit on social responsible activities.

### **Mimetic isomorphism**

Mimetic Isomorphism was clearly observed in the M-PESA case. As stated above, mimetic isomorphism takes place when there is high level of uncertainty in an

industry with regard to either technological or regulatory environment. In the case of mobile money, the regulators (CCK and CBK) did not know exactly how to regulate the business; therefore, the innovator firm, Safaricom was allowed to self-regulate. There had been no such an innovation in developed countries where Kenyan regulators could learn from, as is always the norm of developing countries learning from how developed countries dealt with the regulation of their innovations. There was increase in the level of uncertainty in the industry to the extent that other MNPs that decided to launch mobile money services had to follow the informal norms established by Safaricom. This means that to the extent that Safaricom was socially responsible, its behavior as the leading firm determined the CC practices of the industry, hence a driver for CC.

### **Normative isomorphism**

Normative isomorphism takes place due to the professionalization of an industry especially when firms hire their employees from certain academic institutions, attaching importance to academic credential, and also when the managers of a firm belong to professional associations. These were observable in the two cases. In the EABL case, we observed that most managers of EABL belong to Kenya Association of Manufacturers (KAM) since EABL is a manufacturing firm. We also observed that KAM had a position on the social responsibility of EABL as a leading firm in the beer industry, which was to provide the BOP market with safe affordable alcohol that would solve the social problem of death due to consumption of cheap dangerous alcohol. Kenya Association of Marketers gave them some insights and also gave their social responsibility position with regard to the role of the beer industry.

With regard to reliance on academic credentials and hiring firms from the same academic institution, the Safaricom case that was highlighted became clearer. Safaricom train graduates on software development that would enable the telecommunications industry respond to the needs of the industry. This training is done in one particular university; arguably the leading university in Kenya, which has a tradition of social responsibility built on religious values since it is a religious university run by Opus dei. It is unlikely that these graduates will all work only for Safaricom after completing their Msc. TID. They will probably work for other MNPs like Airtel, Orange, Yu where they will carry their socially conscious mindsets they acquired in Safaricom academy. Some of them may also join the same professional association from which they will continue to share insights. In the end, the telecommunications industry will be more professionalized, hence normative isomorphism with regard to CC practices of the leading firms, Safaricom and EABL.

## Pace setting and catching up

There are two significant roles that leading firms play that lead to the advancement in CC of an industry (pace-setting and catching up). These roles are also observable in the two cases. Pace-setting role is seen in establishing the informal norms through coercive isomorphism as already discussed. Catching up behavior is observable more clearly in the M-PESA case. This was apparent in how Safaricom's competitor, Zain, now Airtel, had entered the market with the mobile money product that added more value beyond what M-PESA offered. This is evident when Zap was marketed, more than just a mobile money service- it was promoted as "mobile wallet". The pricing of Zap was also competitive vis-à-vis M-PESA.

By Zap being packaged as mobile wallet, Safaricom was challenged and had to catch-up with the progress made by its competitor Airtel. This challenge brought to Safaricom's attention the question that had been raised by some experts as to why M-PESA had not fully developed into a savings product. Safaricom responded to the challenge of having to catch-up by launching M-KESHO and later M-shwari. M-KESHO is a package of financial product issued by Equity Bank that runs on the M-PESA transactional rails. The core product is a savings account, but account holders can also tap into loan and insurance facilities<sup>12</sup>.

## CONCLUSION

The two cases that the study employed for illustration purposes have been able to display that the practices of a leading firm in an industry under institutional isomorphism through pace-setting and catching-up can improve the general CC practices of an industry. The two characteristics that make the CC practices of leading firm a CC driver are realized in the context of coercive isomorphic pressures, mimetic isomorphism and normative isomorphism as illustrated by the two cases. In that regard, the current study has contributed to the CC literature in its current form by identifying a neglected CC driver, CC behavior of leading firms in an industry. The study has also identified the behaviors of leading firms that enable them act as drivers for CC, that is, the pace-setting and catching-up behaviors. Another important aspect of the study's contribution is in identifying the contexts in which the socially responsible behaviors of leading firms could be a driver for CC, which is under the three mechanisms of institutional isomorphism.

As managerial implications, organizations that work toward enhancement of CC such as NGOs, could achieve some tangible results by collaborating with leading firms in different industries to ensure that their CC practices are indeed compliant to some acceptable standards. This is because the level of social

responsibility of the industry is to some extent determined by the CC practices of leading firms in the industry. In fact those who champion CC like NGOs that work together with companies should target more the leading firms as their practices are more likely to be replicated by other firms in the industry since firms in the industry tend to copy more leaders (innovators and early adopters). It also follows that there should be clear and objective ways of assessing CC of firms, which is industry specific, reflecting all the CC issues that are industry specific so that firms that replicate the CC strategies of the leading firms can have reliable and valid information.

Nevertheless, there are some limitations to this study especially the use of the cases does not render it generalizable. Moreover, the choice of leading firms (Safaricom and EABL) had been depicted on industry perception rather than on a clearly designated CC ranking. This limitation could not be avoided due to the fact that these firms are currently not ranked and future research should come up with a valid and reliable means of depicting leading firms in their respective industries. In fact future research should go more quantitative by measuring the level of social responsibility of an industry and accessing how the behavior of the leading firms can influence it.

## CONFLICT OF INTERESTS

The author has not declared any conflict of interests.

## REFERENCES

- Aguilera RV, Jackson G (2003). The cross-national diversity of corporate governance: Dimensions and determinants. *Academy of management Review* 28(3):447-465.
- Argenti PA (2004). Collaborating with Activists: How Starbucks Works with NGOs. *California Management Review* 47(1):91-116.
- Baron DP (2010). Morally motivated self-regulation. *American Economic Review* 100(4):1299-1329.
- Baum JA, Rao H (2004). Evolutionary dynamics of organizational populations and communities. *Handbook of organizational change and innovation* pp. 212-258.
- Bernstein MH (2015). *Regulating business by independent commission*. Princeton University Press.
- Campbell JL (2007). Why would corporations behave in socially responsible ways? An institutional theory of corporate social responsibility. *Academy of Management Review* 32(3):946-967.
- Comstock GW (1979). Water hardness and cardiovascular diseases. *American Journal of Epidemiology* 110(4):375-400.
- DiMaggio P, Powell WW (1983). The iron cage revisited: Collective rationality and institutional isomorphism in organizational fields. *American Sociological Review* 48(2):147-160.
- Dore R (1983). Goodwill and the spirit of market capitalism. *The British Journal of Sociology* 34(4):459-482.
- Etzioni A (1989). Status-separation and status-fusion. *Research in Political Sociology* 4:145-165.
- Fama EF, Jensen MC (1983). Separation of ownership and control. *The journal of law and Economics* 26(2):301-325.
- Freeman J, Carroll GR, Hannan MT (1983). The liability of newness: Age dependence in organizational death rates. *American Sociological Review* 48(5):692-710.
- Gray ER, Balmer JM (1998). Managing corporate image and corporate reputation. *Long Range Planning* 31(5):695-702.

<sup>12</sup> . <http://financialaccess.org/node/2968>

- Greenwood R, Meyer RE (2008). Influencing ideas: A celebration of DiMaggio and Powell (1983). *Journal of Management Inquiry* 17(4):258-264.
- Greyser SA, Klein N (1996). Brent Spar Incident, The: "A Shell of a Mess". Available at: <https://www.hbs.edu/faculty/Pages/item.aspx?num=20136>
- Hall PA, Sosckie DW (2001). Varieties of capitalism: The institutional foundations of comparative advantage. Oxford: Oxford University Press. The Oxford Handbook of Classics in Public Policy and Administration. Available at: <http://digamo.free.fr/hallsosk.pdf>
- Hemingway CA, MacLagan PW (2004). Managers' Personal Values as Drivers of Corporate Social Responsibility. *Journal of Business Ethics* 50(1):33-44.
- Hannan MT, Freeman J (1977). The population ecology of organizations. *American Journal of Sociology* 82(5):929-964.
- Lee MDP (2008). A review of the theories of corporate social responsibility: Its evolutionary path and the road ahead. *International Journal of Management Reviews* 10(1):53-73.
- March JG, Olsen JP (1976). Organizational choice under ambiguity. *Ambiguity and Choice in Organizations* 2:10-23.
- Margolis JD, Walsh JR (2003). Misery loves rethinking companies: Social initiatives. *Administrative Science Quarterly* 48(2):268-305.
- McKelvey B (1982). Organizational systematics--taxonomy, evolution, classification. University of California Press.
- Meyer JW, Rowan B (1977). Institutionalized organizations: Formal structure as myth and ceremony. *American Journal of Sociology* 83(2):340-363.
- Meyer JW, Scott WR (1983). Organizational environments: Ritual and rationality. Sage.
- MSteger U (2006). Building a business case for corporate sustainability. In *Managing the business case for sustainability*: In: Schaltegger S, Wagner M (eds.), The integration of social environmental and economic performance. Sheffield: Greenleaf. pp. 412-443.
- North DC (2004). Partnership as a means to improve economic performance. *Evaluation and Development: The Partnership Dimension*, Liebenenthal A, Feinstein ON, Ingram GK (eds). World Bank Series on Evaluation and Development pp. 3-7.
- Ofori DF, Debrah Y (2014). Corporate social responsibility in Sub-Saharan Africa: hindering and supporting factors. *African Journal of Economic and Management Studies African Journal of Economic and Management Studies*, 5(1):93-113.
- Othman R, Othman R (2014). Higher education institutions and social performance: Evidence from public and private universities. *International Journal of Business and Society* 15(1):1-18.
- Roman RM, Hayibor S, Agle BR (1999). The relationship between social and financial performance: Repainting a portrait. *Business and Society* 38(1):109-125.
- Schwaiger M (2004). Components and parameters of corporate reputation—An empirical study. *Schmalenbach Business Review* 56(1):46-71.
- Snider J, Hill RP, Martin D (2003). Corporate social responsibility in the 21st century: A view from the world's most successful firms. *Journal of Business Ethics* 48(2):175-187.
- Stinchcombe AL (1965). Organizations and social structure. *Handbook of Organizations* 44(2):142-193.
- Suchman MC (1995). Managing legitimacy: Strategic and institutional approaches. *Academy of Management Review* 20(3):571-610.
- Tolbert PS, Zucker LG (1983). Institutional sources of change in the formal structure of organizations: The diffusion of civil service reform, 1880-1935. *Administrative Science Quarterly* 1983:22-39.
- Vagadia B (2012). Strategic Outsourcing Management for Professionals.
- Valor C (2005). Corporate Social Responsibility and Corporate Citizenship: Towards Corporate Accountability. *Business and Society Review* 110:191-212.
- Vogel D (1989). *Fluctuating fortunes: The political power of business in Great Britain and the United States*. New York: Basic Books.
- Wagner M, Schaltegger S (2004). The effect of corporate environmental strategy choice and environmental performance on competitiveness and economic performance: An empirical study of EU manufacturing. *European Management Journal* 22(5):557-572.
- Weber M (2008). The business case for corporate social responsibility: A company-level measurement approach for CSR. *European Management Journal* 26(4):247-261.
- Whetten DA, Aldrich H (1979). Organization setsize and diversity: people-processing organizations and their environments. *Administration and Society* 11(3):251-281.
- Whitley R (2004). The social construction of organizations and markets: The comparative analysis of business recipes. *The new economic sociology*. pp. 162-187.
- Williamson D, Lynch-Wood G, Ramsay J (2006). Drivers of environmental behaviour in manufacturing SMEs and the implications for CSR. *Journal of Business Ethics* 67(3):317-330.

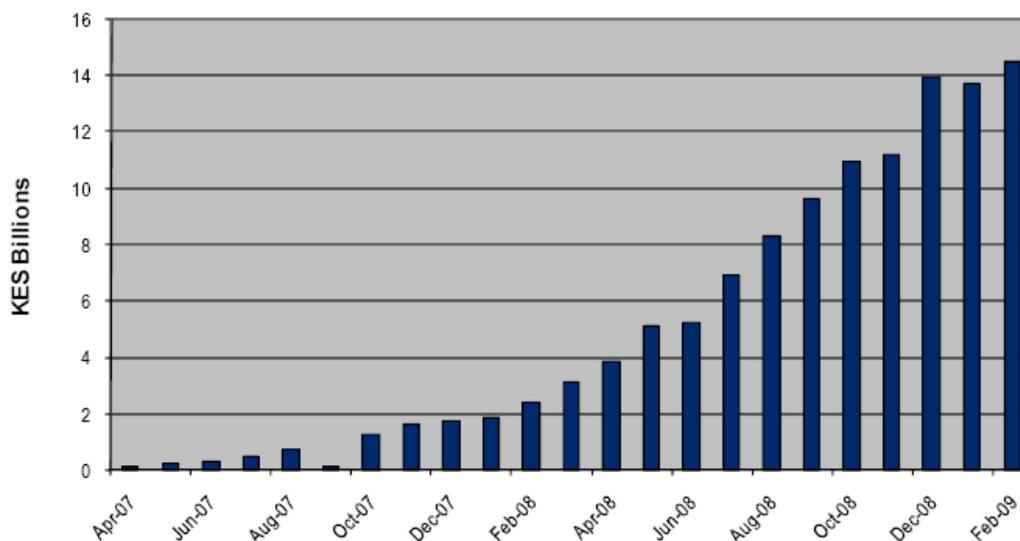
APPENDICES



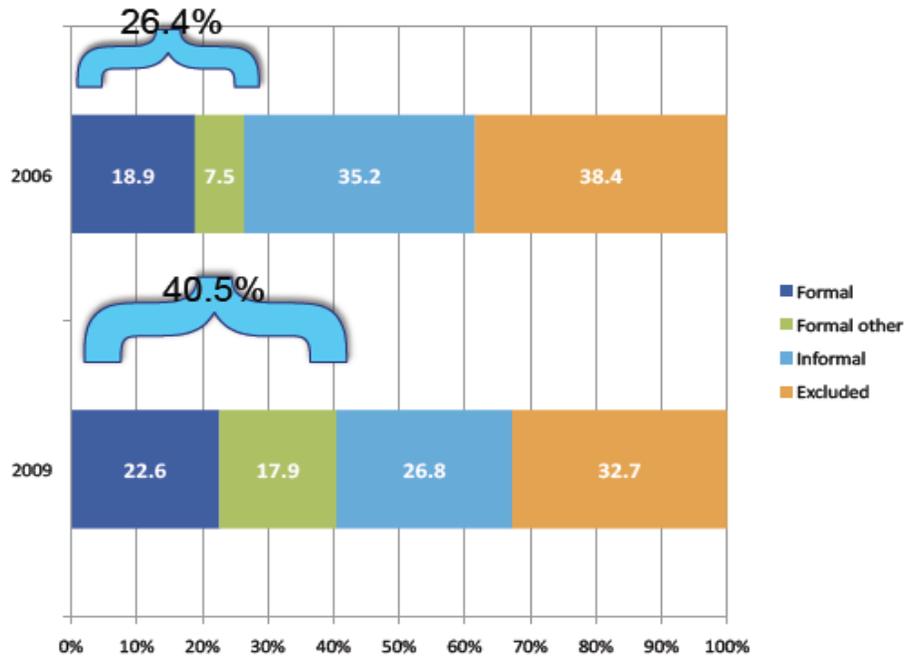
- Performs a number of basic financial transactions that revolve around transfer of money
- Users are able to send money, withdraw money, buy airtime, pay bills among others
- Users visit authorized agent shops where they deposit funds or make withdrawals.

Appendix 1. How M-Pesa works.

M-Pesa Value Transfers (Person to Person only)



Appendix 2. Exponential growth of M-Pesa.



Appendix 3. Reduction of unbanked population in Kenya: 2006-2009 comparison.

*Full Length Research Paper*

# The rules of business transformation

Allan D. M. Bukusi

Africa Leadership and Social Development Centre, Nairobi, Kenya.

Received 13 September, 2020; Accepted 13 October, 2020

**Business transformation initiatives update a company's production methods and aim to ensure it operates more efficiently. However, the author suggests that a reactive, piece meal approach to needed change relegates a company to lagging behind its market and stagnates its growth. A proactive, holistic approach to business transformation ensures that a company is attuned to its evolving market environment. It secures the long term the survival, sustainability and success of a company. Findings from this study suggest that customer focus, transformative strategy, ethical practices and well executed growth metrics are essential for successful business transformation. The study shows that transformative leaders step away from limited competitor driven tactics to focus on securing long term growth, superior service delivery and stakeholder satisfaction. These companies use technology to unlock new markets and engage in open collaboration with their customers to create valuable new products. The study reviews metadata drawn from published interviews with transformative CEOs to derive the rules of business transformation. While there are many business development options to choose from in the 21st century, the author challenges company management teams to rethink their company strategy and adopt the essential rules of business transformation to secure their long term survival and success. The study suggests that business transformation is not about making a profit from a bottom-line business plan. Rather, it is about taking the lid off performance, ensuring company sustainability and relevance while fulfilling stakeholder expectations, today and into the future.**

**Key words:** Transformative strategy, business transformation, ethical leadership, transformative leadership, sustainable performance, business rules, 21st Century.

## INTRODUCTION

So, what's new in business transformation (Faeste and Hemerling, 2016), why do we need transformative leaders to address contextual change (Grin et al., 2018) and why do we need to renew our organizations (Mckinsey and Company, 2016)? What has changed since Henri Fayol and Alfred Sloan put together scientific management theory to get factories to operate more efficiently. What has changed since Henry Ford developed a method of mass production that made the

Black Model T Ford available to the average American (Wren and Bedeian, 2009) and what has changed since Peter Drucker talked about Management by Objectives, MBO and later the concept of the corporation (Drucker, 2009)? How have businesses evolved through Total Quality management, TQM (Mohanty and Lakhe, 2008), Gemba Kaizen (Imai, 2012), Balanced Score Card, BSC (Kaplan and Norton, 1996) and Business Process Reengineering, BPR (Hammer and Champy, 2006)

E-mail: [allanbukusi@gmail.com](mailto:allanbukusi@gmail.com). Tel: +254-715-201-535.

Author(s) agree that this article remain permanently open access under the terms of the [Creative Commons Attribution License 4.0 International License](https://creativecommons.org/licenses/by/4.0/)

alongside other developments in business management theory including Management by walking around, MBWA (Peters and Waterman, 2004)?

A close examination of these structural, systems and philosophical business development approaches reveal an underlying need for companies to continuously change, adjust and transform themselves in order to keep pace with the advancing and evolving environment. New ways of doing business do not come about because the old ways have failed. Rather, they come about because the environment has moved on and new opportunities have opened up. A business that does not adjust is likely to suffer strategic dissonance with its evolving environment. Such a business will find itself with unsellable goods, outdated technology and a rotting philosophical core of a dying, irrelevant business outfit (Montgomery, 2013). From the end of the agrarian age to the industrial revolution, through to the information age and now the exponential power offered by innovation and technology, businesses have had to keep transforming to simply remain in business. The bottom line of business survival is that a business must transform itself and keep pace with the changing environment if it wants to survive the long term. The topline of business success is to either: a) study where the market is going and position the company to advance it, or b) advance the market to where it believes the market wants to go.

However, undertaking business transformation simply because other companies are transforming is to miss the point. Business transformation helps a company optimize performance, productivity and profitability in the context of its operating environment. Nonetheless, the need for a constant state of vigilance suggests that the company itself is in a constant state of transition. Improvements serve a purpose for a period. Once that period is over or new opportunities arise, a company must move on to refine or redefine itself to remain relevant in its market. The challenge today is that change is so rapid and dynamic that non-investment in business development is as costly as investment in a product that fails to meet market expectations. Yet, the Internet of Things, IOT is urging businesses to quickly rethink basic concepts such as “factory”, “office” and “production” in pursuit of unfolding new business opportunity (Rogers, 2003).

The challenge CEOs and management teams have today is to keep their business attuned to the environment while serving the interest of stakeholders. Companies have to keep changing and growing in order to remain relevant, reliable and competitive (Caldwell et al., 2012). However, just how do you achieve superordinate performance in the rapidly evolving, dynamic and disruptive 21st century environment. With many different approaches on offer, what are the basic rules of business transformation that every CEO and management team should observe in order to avoid a company lapsing into unproductive oblivion.

Business transformation today is rendered urgent by

four important factors: First, the departure of the stable and long-range economic planning environments; second, the enlightenment of the customer and the growing power of stakeholders; third, the ease of use and availability of information and other technologies; and fourth, the arrival of the highly dynamic and disruptive business environment of the 21st century. Business that survive today's conditions make technology work for them (Davila et al., 2006) and find innovative ways to thrive and grow in turbulent times (Hamel, 2002). While the new century has unleashed an unprecedented chaotic environment onto the business world, managers are still expected to deliver outstanding performance. This author researched the approaches used by recognized CEOs to turnaround company performance in unstable market conditions and presents them as useful rules for successful business transformation.

## MATERIALS AND METHODS

This study reviewed interviews published in the June 30, 2013 Sunday Nation Newspaper pullout titled, “Transformative CEOs with Golden hands” (Nation Newspapers, 2013). The pullout featured 37 CEOs and company profiles. The report covered 30 men and 7 women. Eight of these CEOs held doctorate (PhD) degrees. The organizations ranged from Billion-Shilling corporations to SMEs and successful startups in both the public and private sector. Industry categories included Public service (2), Retail (1), Real Estate (1), Education (5), Finance (9), Technology (3), Regulatory authorities (6), Manufacturing (5), NGO (1) Agriculture (1), Insurance (1) and Services (2).

This study used metadata from this publication to examine the transformative impact these CEOs had on their company and analyzed the available descriptive statistics to identify the characteristics that describe a transformed or transforming business. The study sought to identify: a) the strategy employed by each CEO/ organization; b) the leadership philosophy that prevailed during the period of transformation; c) the measurable growth metrics of such an organization; and d) the time frame in which transformation was achieved. The study also sought to highlight common qualities that identify transformative CEOs. The study findings were analyzed using descriptive statistical techniques of data arrangement and thematic evaluation of the text. The study sought to identify commonalities and disparities among the sample population. Drawing from transformative leadership theory, the researcher derived ten rules of business transformation. The study assumes that the selected CEOs, under whose stewardship the organization achieved phenomenal success, were intentional in their leadership efforts to transform the state of the business. The study was limited to the information and data provided by the published report.

### Transformative leadership

Caldwell et al. (2012) describe transformative leadership as “an ethically based leadership model that integrates a commitment to values and outcomes by optimizing the long-term interests of stakeholders and society and honoring the moral duties owed by organizations to their stakeholders” (Caldwell et al., 2012: 176). The authors explain that it draws on six leadership approaches namely: Transformational leadership (Burns, 1978); Charismatic leadership ability (Bass, 1985); Level 5 Leadership (Collins, 2001); Principle centered leadership (Covey, 1991); Servant leadership (Greenleaf,

2003); and Covenantal Leadership (Senge, 2006). This aspirational form of leadership challenges managers to ensure that the company accomplishes the goals it sets out to achieve and keeps the promises it makes to the public. While this study draws on the corporate definition offered by Caldwell et al. (2012), an overview of broader transformative leadership theory provides further understanding of its operational principles.

The observance of ethics is critical to enable transformative organization change through the participation of individual agents (Langlois, 2011). Shields, describes transformative leadership as a process of managing change by deconstructing and constructing new ways of thinking to facilitate organization transformation (Shields, 2011). Montuori and Donnelly define transformative leadership at its heart as a “participatory process of creative collaboration and transformation for mutual benefit” (Montuori and Donnelly, 2017). These authors also develop the idea that leaders and followers engage in interchangeable roles to ensure overall goals are achieved through collaborative teamwork. Eisler and Carter overturn the conventional top-down view of leadership and call for a partnership that harnesses voices at all levels of organization, as a more effective approach to achieve corporate goals (Eisler and Carter, 2010). Transformative leadership challenges leaders to adopt adaptive methods to address crisis rather than relying on conventional theory to tackle evolving challenges in a dynamic environment (Keeney, 2010). Ncube (2010) calls for the establishment of a sense of community ethos in striving together for higher goals.

## RESULTS AND DISCUSSION

The data was analyzed and tabulated showing the company industry, name, transformative approach, leadership philosophy, growth metrics, magnitude of transformation, transformation period and years as shown in Table 1 and its interpretation in Table 2.

### Industry distribution

The industry distribution in this sample size shows that a majority of the firms were drawn from Financial (24%), Manufacturing (16%), Education (13%) and Regulatory authorities (13%) as shown in Figure 1. Though this analysis indicates that this study would mostly find application in financial institutions, manufacturing firms, educational institutions and regulatory authorities, it does give a broad spread between private and public (government) organizations. This indicates that the principles of business transformation are not restricted to private enterprise, but can be implemented in non-commercial enterprises as well (Hammer and Champy, 2006). Nonetheless, the size of the organizations referenced indicates that business transformation can be activated in both small and large companies alike. This suggests that there are no special qualifications for an organization to embark on a transformation journey.

### Transformative strategy

In the sample population, 10/37 (27%) companies used a

strategic plan to enable transformation, 8/37 (21.5%) employed technology and innovation, 4/37 (11%) used a customer-oriented approach, 4/37 (11%) used a form of BPR. 3/37 (8%) focused on expansion, while 8/37 (21.5%) used other approaches to drive transformation. The percentage distribution is shown in Figure 2. This evaluation indicates that the most common approach used by transforming businesses is to design and implement a transformative strategic plan, masterplan or a super-ordinate plan that guides and aligns company operations (Montgomery, 2013). The second most used approach is to employ technology and adopt innovative methods to drive the transformation process alongside customer focused initiatives (Davila et al., 2006). The third approach implements business process improvement programs such as; BPR, TQM, BSC and International Standards Organization, ISO certification (Hammer and Champy, 2006). While many companies may have a strategic plan or may be in the process of implementing some sort of business improvement program, not all of them will have these two elements speaking to each other in a far sighted transformative strategic document.

### Philosophy

From the study, 16/37 (43%) organizations employed a Strategic Human Resource Development, SHRD driven approach, while 9/37 (24%) employed a customer driven approach. Four companies 4/37 (11%) employed ethical leadership principles, while 8/37(22%) employed other management related approaches. The percentage distribution is shown in Figure 3. These findings indicate that the sample organizations employed a three-point people focus in establishing a transformational philosophy. In this study, 43% of the companies developed equipped and empowered their human resource teams to delivery competent services (Armstrong and Taylor, 2014). The second largest category focused on customer service and the third category focused on individual and social ethical responsibility (Langlois, 2011). In reality these three elements are points of emphasis of a core community ethos or corporate organization undertaking to improve business performance (Ncube, 2010).

### Growth measures

The analysis shows that transformative growth metrics are measured variously. The metrics include:

- a) Multiplying the range of products or services provided;
- b) Substantive financial returns in terms of turnover or profitability;
- c) Physical expansion and service reach;
- d) massive expansion in customers served; and
- e) Organization turnaround, from loss to profit.

**Table 1.** Organization characteristics.

RefNo.	Ind.	Org.	Trans. approach	Philosophy	Growth metrics (Ks-Million/Billion)	Mag.	Trans. Period	Years
1	AGR	KTDA	Technology and innovation	Professional, dedicated workforce	45 » 65 New factories	1.44	2000-2013	13
2	EDU	COI	Improved facilities	Motivation and innovation	New campus amphitheater	-	2007-2013	6
3	EDU	KASNEB	BPR	Providing user friendly services	New Linkage with Edu. Institutions	-	2008-2013	5
4	EDU	KMTC	Expansion	Human touch	13,000 » 20,000 Students	1.54	2009-2013	4
5	EDU	KU	Strategic plan	Transformational leadership	15,000 » 61,000 Students	4	2006-2013	7
6	EDU	SBS	Quality	Servant leadership	10 » 40 Investors	4	2004-2012	8
7	FIN	BARODA	Gradual expansion	Relationship management (Kingdom bank)	1 » 10 Branches	10	1960-2012	52*
8	FIN	COOP	Unit Integrity and accountability	<i>Ethical leadership</i>	2.3 B Loss » 2.3 B Profit	∞	2001-2007	6
9	FIN	DTB	Technology	Energetic mindsets, adaptable, innovative	5.5B » 138.7B 5 » 90 Branches	25	2001-2013	12
10	FIN	EQUITY	Customer service	People	21M » 200B in Deposits 2,942 » 8.3M Customers	∞	1994-2013	19
11	FIN	FAMILY	BSC, Re-Eng. and new services	Performance culture	21.9B » 32.7B Balance sheet	1.5	2011-2013	2
12	FIN	LAPTRUST	Corporate strategic plan	Commitment to superior service ISO	3.7B » 19.4B Fund growth	5.24	2006-2013	7
13	FIN	POSTBANK	Technology	Understanding customer needs	99 Branches » 680 Agents	6.9	2008-2013	5
14	FIN	RAFIKI	Innovation	Remaining relevant and focused	1 » 50,000 Customers	e	2011-2013	2
15	FIN	STANLIB	Wealth creation	Investment culture	70B » 200B Turnover	2.86	2010-2013	3
16	INS	PALA	Performance improvement	Team spirit	117M » 834M Turnover	7	2008-2012	4
17	MAN	BETA	Technology, people and research	Tenacious teamwork	New manufacturing plant	-	-	-
18	MAN	CROWN	BPR	Knowledge sharing culture	1.2b » 4.4b Turnover	3.67	2005-2012	7
19	MAN	GMEA	Customer value	Team trumps talent	18.5 » 26% Market share	1.4	2010-2012	2
20	MAN	KENGEN	Strategic plan(good to great)	Diligent staff	800mw » 1300mw Electrical power	1.65	2003-2013	10
21	MAN	KENYA POWER	Connecting power to customers	Customer focused teams	15 » 35% Customer access	2.3	2007-2017	10
22	MAN	KEROCHE	Authentic local product	Made in Africa	3% » 20% Market share	6.67	2009-2013	4
23	PSC	KTDC	Marketing	Performance culture	Funded 200 projects bed capacity & quality	-	2009-2013	4
24	PSC	KWS	Strategic plan	Right staff and stakeholder	Increase in population of species	-	2012-2017	5
25	REA	AWSB	Strategic master plan	Improving access to water services	Water sector reforms	-	2011-2013	2
26	REA	CDSC	Technology	Effectiveness and efficiency	200 » 2700 Transactions 30,000 » 1.97m Clients	65	2004-2013	9

Table 1. Cont'd

27	REA	KCA	Accountability	Public service	Financial sustainability	-	2010-2014	4
28	REA	KCAA	Strategic upgrade plan	ISO certified quality standards	Revamped operating services	-	2002-2013	11
29	REA	KENHA	Vision 2030	Quality Service delivery	New national road network	-	-	-
30	EST	SURAYA	Changing lifestyles	Family teamwork	30 » 3000 Housing units	e	2007-2013	6
31	RET	UCHUMI	Customer service	People are important	Loss » Profit 32 Branches	∞	2006-2012	6
32	SER	KICC	Strategic goals (1.8 » 3 m visitors)	Attracting global conferences	Revamping services locally	-	-	-
33	SER	POSTA	Strategic revenue plan	Electronic service delivery	Laying ICT service infrastructure	-	2013-2016	3
34	SER	VSO	Volunteerism	Driving social change	Impacting lives at the grassroots	-	-	-
35	TEC	COMPULYNX	Strategic plan	Trust, teamwork, efficiency	» 400 (x16 countries)	16	2009-2013	4
36	TEC	MTN	Technology	Communications solutions	Innovative digital business support	-	2010-2013	3
37	TEC	SEVEN SEAS	Technology Innovation	Talent development	Business solutions	-	1999-2013	14

Table 2. Interpretation legend for table 1.

Header	Description
Ref. No.	Population element number
Ind.	Industry; AGR- Agriculture, EDU- Education, FIN-Financial services, INS- insurance, MAN- Manufacturing, PSC- Public service company, REA-Regulatory Authority, EST- Real estate, RET- Retail, SER- Services, TEC- Technology. NGO- Non-Governmental Organization
Org.	Abbreviated name of the organization
Trans. Strategy	Identified transformative strategy adopted by the organization
Philosophy	Philosophy driving transformation initiatives
Growth measure	Measurable growth indicators, the financial figures are in Kenya Shillings, M = Millions & B = Billions
Mag.	Order of magnitude of transformation Mag= Growth measure after trans. period/growth measure before trans. period
Trans. Period	Years of transformative period under review
Trans. Years	Numbers of transformative period years.
-	The (-) sign indicates no data available from the source document
52*	This figure was not included in the statistical calculations in this study

The findings suggest that there is no-one-size-fits-all measure of performance and neither is it available in a linear measure. Analysis of the data text suggests that each company predetermined the metric they would use to measure growth. The

metrics ranged from increased products and services, more customers, company expansion, to financial performance (Bukusi, 2017). Companies need to be flexible and creative in determining their growth rather than stick to conventional

methods (Keeney, 2010). The analysis indicates that transformation metrics can be changed or adjusted as the company transforms. Some companies registered growth in several metrics. It also suggests that a company needs to make a

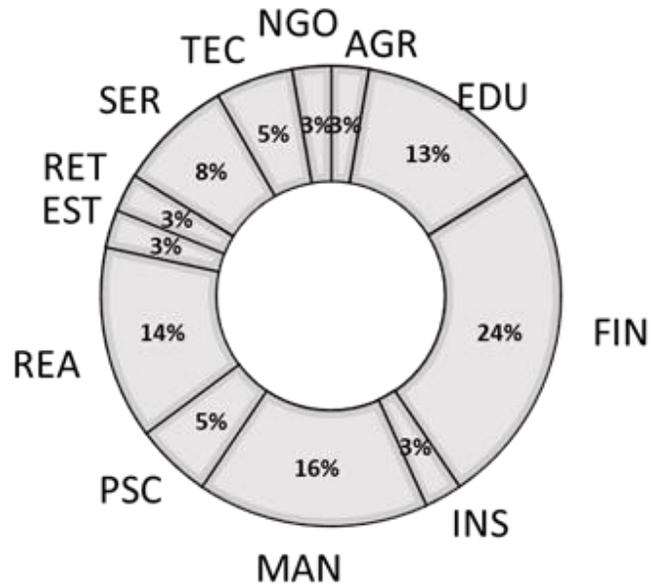


Figure 1. Sample population industry distribution.

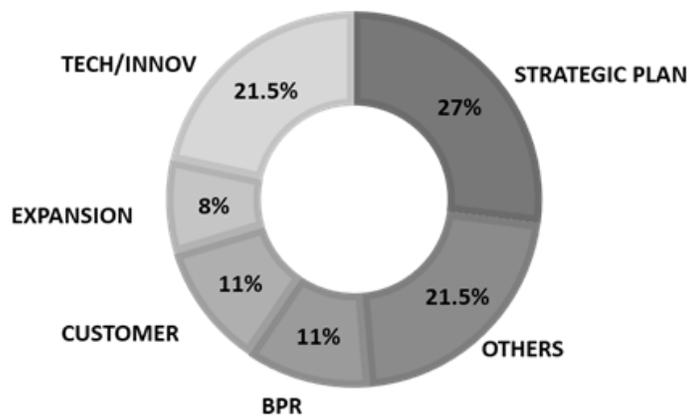


Figure 2. Transformative strategy distribution approach.

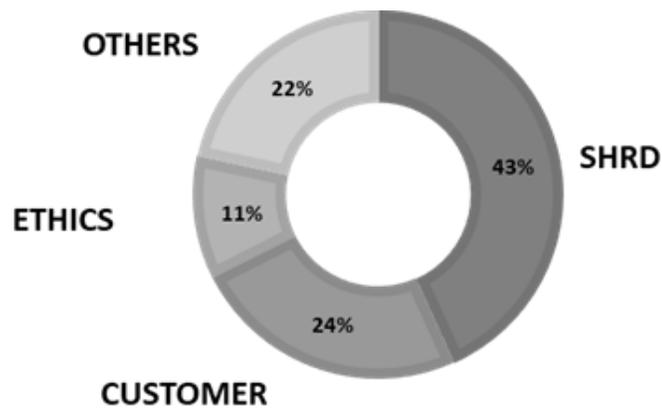


Figure 3. Leadership philosophy distribution.

careful selection of the metric they choose to measure, monitor and drive company growth (McChesney et al., 2012). Choosing a poor metric causes a company to put its efforts and resources into low impact initiatives resulting in unprofitable outcomes.

### Order of magnitude

The data shows seven orders of magnitude where organizations are recognized as transformative by their level of: a) innovation, projects, structural reform or other high impact initiative; b) turnaround performance from substantive loss to substantive profit shown as an infinity ( $\infty$ ) sign; c) magnitude of growth in excess of 1.44 and multipliers of x4, x7, x10; and d) exponential (e) growth of the order of 100 and beyond.

This section can be interpreted in the same manner as the explanation of the growth measures above. The measure of growth chosen by the company will require the company to consider “by how much” the company should grow in that area. For example, a company focusing on growth of its customer accounts must monitor and drive its transformation by growing its customer accounts. However, the data shows that transformative growth is only achieved when the numbers exceed a factor of approximately “1.5” times the original number at the start of the plan period. In other words, growth from 100 customer accounts to 110 customer accounts is growth but it is not transformative growth. Similarly, a hotel expanding its bed facilities from 10 rooms to 11 rooms is not transformative. The hotel must put in place measures to achieve beyond 15 rooms. While the growth measure of “1.5” appears to be the minimum, the data shows that transformative growth is measured in quantum leaps (Bukusi, 2017) in multiples of trend growth, rather than incremental units.

### Transformative years

The following descriptive statistics from the sample population provided insight on the number of years it takes to transform a company. Median = 5.5yrs, Mode = 4yrs, Average = 6.47yrs, Standard deviation = 3.96yrs, Inter quartile range Q1=(2-4yrs), Q2=(4-5yrs), Q3=(6-8yrs), Q4=(9-19yrs).

The analysis showed that the average time it took for a business to accomplish transformation was 6.47 years. However, the largest number (mode) of companies in the sample took 4 years, while the middle point (media) in the range was calculated at 5.5 years. The standard deviation was calculated at 3.96 years with the first three interquartile ranges Q1, Q2, Q3 registering a 2-year interval. These findings suggest that it would take between 4 and 6 years to register a sustainable business transformation initiative. This may be due to the need to put in place structures and organization systems to

support the process and not just record outstanding results in one or two exceptional seasons. This latter interpretation is further expounded in the following rules.

### Rules of business transformation

This section also draws from the text of the published interviews to interpret and discuss the findings gathered from the data tables.

#### *Transformative strategy rule*

*A business seeking to achieve successful transformation should draw up a long term transformative strategic plan, master plan or superordinate plan; preferably running in several phases over 4-18 years. The plan should incorporate a technology, customer and a business operations makeover.*

The study revealed that 27% of the companies chose to develop and implement a transformative strategic plan. Companies may choose to brand the plan to ensure management does not go about it as a normal plan. Two companies in this study chose, *Master Plan* and *Good to Great* as their titles while 15/37 (41%) linked the uniqueness of their plans to the transformative Kenya Vision 2030 initiative (Vision 2030 Delivery Secretariat, 2007). Typically, the plan ran in several phases providing a superordinate framework to satisfy stakeholder interests. However, strategic growth was not measured by routine incremental profit, but by the achievement of strategic milestones. This shift in perspective may be what separates transformative companies from normative companies pursuing incremental annual growth. A transformative strategic plan is proactive and preemptive unlike conventional business plans that respond and react to market shifts.

#### *Technology rule*

*Harness innovative technology to maximize productivity and provide a platform for further growth.*

The second driver of organization transformation is the adoption and deployment of technology and innovation (21.5%). Technology and innovation provide an immediate hyper jump or quantum leap in company performance. The investment pays off in increased capacity to do more business in real time (Hamel, 2002). Thus, startups and technology firms are able to register phenomenal short-term growth.

#### *Business process improvement rule*

*Continuously engage service and operational improvement*

*and efficiency as a process of keeping attuned to evolving market needs.*

Third, is a tie between companies that focus on customer service (11%) and BPR (11%). Customer service takes a wager to grow a business to meet the evolving needs of the customer. In these cases, transformation is pursued in response to customer queries, expectations and satisfaction. BPR systems ensure the company maximizes the use of its available resources.

### **Philosophy rule**

*A transforming business engages an ethical staff development and customer focused ethos that celebrates service delivery, embraces change that stimulates personal, business and environmental transformation.*

Internally driven companies employ strategic human resources development, SHRD, approaches that center on performance management, teamwork, people development and professionalism. Externally motivated customer focused philosophy incorporates; customer service, creating value, research and sharing of information. Virtually all the companies listed in this study had vibrant ethos, vision, mission, values and strategic priorities championed by the CEO (Shields, 2011). A second more subtle conversation is the organization commitment to ethical business practices (Langlois, 2011) and participation of all the voices in the transformation process as members of teams and contributors of ideas (Eisler and Carter, 2010). Members of such organizations subscribe to the company ethos and values (Ncube, 2010). Successful CEOs are passionate about the organization's strategic intent, but also engage people as moral agents of change with the knowledge, expertise and talent to facilitate transformation (Covey, 1991).

### **Transformative growth metric rule**

*Companies need to carefully select and focus effort and resources on an appropriate growth metric to drive business transformation.*

The data analysis reveals five distinct Transformative Growth Metrics (TGM) or measures of transformation. TGM1- The adoption of an initiative, innovation or project that substantially changes the brand, competence or capacity of a company to do more business; TGM2- The achievement of a substantive turnaround from loss to profitability; TGM3- The achievement of digital growth and replication of unit performance; TGM4 – The multiplier growth which enables the organic spread of a business into new markets; and TGM5 – The realization of massive service and customer impact influence. This

growth metric scale is not proposed as a linear continuum. Rather the TGM is a quantum measure of what the company sets out to achieve in “milestones” to accomplish. While conventional companies measure growth in terms of market share and bottom-line performance, transformative companies track growth in terms of accomplishment of strategic milestones.

### **Order of magnitude rule**

**Businesses are transformed in quantum leaps and not linear progression or gradual improvement:** The minimum order of magnitude appears to be “1.5”. A business cannot be said to be transformative unless its, turnover, customer base or other measure of growth exceeds the previous plan period by more than 50%. This metric suggests that anything less than 50% growth may be incremental development, but may not be noticeable or substantive enough to be labeled “transformative”. Growth in excess of 50% is noticeable by any measure and changes the character of a business in terms of outlook, branding, culture and performance. This measure of growth induces a paradigm shift and quantum leap in the nature of business operations. This finding suggests that CEOs need to select, define and drive a “50% growth target” in a selected TGM. For example, a newspaper increasing its circulation by 50% is likely to experience massive new inflows in revenue. This shift in customer service will demand and require a major facelift of its production technology, scaling it up for further growth. Setting a transformative growth target, TGT may be a useful technique to trigger business transformation.

### **CEO legacy rule**

**Transformative leaders leave a progressive legacy:** Transformative CEOs are expected to drive ethical growth, where ethics extends to an organization keeping its mission promises, service delivery and stakeholder commitments. Ethics involves leaving an organization better than one found it (Senge, 2006). In this study 9/37 (24%) of the CEOs were quoted as committing to a legacy ... *“I pray to leave a legacy as a CEO who boldly served God in the market place and who led co-operative Bank to diligently serve the Kenyan people and, in the region,” (Muriuki) “I want to be remembered for my transformative leadership and double growth. As such, want to impact our employees by developing their capacity and exposing them to what is being done better elsewhere, so they can add value to our customers” (Kaveshe) “... As a director who confronted poaching head on and brought it to an end and one who built and maintained a cohesive team” (Kiprono)... “A CEO who came and made a difference” (Advani), “To leave behind an institution that is a centre of excellence in teaching and learning, research and innovation and the provision*

of defining research output that offers solutions to societal challenges and enhances the quality of life of the people of Kenya. I also want to be remembered as a VC who created a truly world class University that is globally competitive” (Mugenda), “When he joined KMTTC, the student population was a paltry 13,000. Today, the college boasts of more than 20,000, and is still growing, giving thousands of Kenyans a chance to train at the Premier college, a legacy he says he would want Kenyans to remember him for” (Onudi)... “to me, service as an individual and public servant is about God and country” (Jordan),... “You [Njoroge] will leave a strong legacy, having made a great difference in KenGen, Kenya as a country and Africa as a continent” (Njoroge), “a legacy of dedication to nation building” (Kili).

Other commonalities of these CEOs include: a) acceptance of the leadership challenge in the situation (Kouzes and Posner, 2012), b) embraced the troubled environment in which they were thrust, not shying away from the chaos or reality on the ground (Montuori, 2010), c) committed to the cause of the institution, but also made a promise to teamwork, participatory process and human resources development (Burns, 1978). The office of the CEO carries a substantive burden of the responsibility for company performance. The office can be considered as an organization “structure” or “institutional” asset (Collins, 2001). Transformative CEOs appear to drive business performance and take on the entrepreneurial role of growing the enterprise. Nonetheless, it may be that it is “legacy” rather than “results” or “rewards” that drives transformative CEO performance (Caldwell et al., 2012).

### **Six-year rule**

**It takes 6 years to establish corporate structures to sustain business transformation:** The 6-year marker appears to be a critical time period indicator of successful transformation. This marker may also be tied to a phase of a strategic plan, it also suggests that it may be impractical to expect transformation in a shorter time frame. Hence normative annual plans are unlikely to achieve transformative outcomes. This may be valuable information for governing boards appointing CEOs and top leadership teams to transform a business. In other words, boards seeking company transformation need to provide 6-year CEO contracts, with a two-year threshold evaluation point, to provide sufficient time for the CEOs to engineer change. CEOs serving a four-year term may just have time to lay the groundwork of a master plan. The six-year rule also suggests that appointing a non-transformative leadership team to pursue business transformation can be a costly mistake. It may take six years to find out that the company does not have the *right* team in place. The six year rule also underscores the importance of having a phased, superordinate plan to

pipeline the process of transformation.

### **SHRD rule**

**Business transformation is driven by visionary leaders and strategic human resources:** While it is easy to celebrate the efforts of a CEO in transforming a business, the role of SHRD cannot be ignored. In this study it scores 43%, the highest individual score influencing company transformation. This highlights the importance of hiring, equipping, developing and empowering business teams to enable and sustain new levels of performance. The team needs to capture the spirit of the organization and interpret the intent of the CEO to facilitate the desired transformation (Ncube, 2010). Not developing a strategic, as opposed to operational, team may place an unrealistic burden on the CEO and introduce institutional inertia to the transformation process (Greenleaf, 2003).

### **The stakeholder rule**

**Business transformation is upheld by stakeholder satisfaction and corporate social responsibility:** Under the Philosophy rule, external stakeholders (customers) and internal stakeholder (staff) drive a combined 67% of a company’s ethos or reason for existence. This would support Caldwell et al assertion of leadership’s accountability to stakeholders (Caldwell et al., 2012). The Stakeholder rule suggests that all (internal and external) stakeholders are critical to successful business transformation. The stakeholder resource is mobilized and substantively engaged in the success of any transformative process. However it also calls for the ethical sharing of benefits with all business stakeholders. The onboarding of stakeholders appears to be a valuable investment in driving successful business transformation.

### **Conclusion**

The CEO and management teams are critical players in the pursuit of the corporate goals and social mission of the organization, providing transformative, transcendent leadership to guarantee long term institutional survival. Findings from this study indicate that business transformation can be described as the mechanisms a company puts in place to ensure the survival, growth and expansion of its service provision to satisfy evolving stakeholder demands. Such a business achieves sustainability by remaining relevant, attuned to its dynamic environment and enjoys trend growth as opposed to incremental growth over the long term.

### **CONFLICT OF INTERESTS**

The author has not declared any conflict of interests.

## REFERENCES

- Armstrong M, Taylor S (2014). *Armstrong's handbook of human resource management*, 13th Ed. London: Kogan Page.
- Bass (1985). *Leadership and performance beyond expectations*. New York: Free Press.
- Bukusi A (2017). Transformative leadership. In Bukusi A (ed.), *Transforming Africa*. Nairobi: MDI. pp. 128-131.
- Burns J (1978). *Leadership*. New York: Harper & Row Publishers.
- Caldwell C, Dixon RD, Floyd LA, Chaudoin J, Post J, Cheokas G (2012). Transformative leadership: Achieving unparalleled excellence. *Journal of Business Ethics* 109:175-187.
- Collins J (2001). Level 5 leadership. In Collins J (ed.), *Good to great*. New York: Collins pp. 17-40.
- Covey SR (1991). *Principle-centered leadership*. London: Simon & Schuster.
- Davila T, Epstein MJ, Sheldon RD (2006). *Making innovation work: How to manage it, measure it and profit from it*. Upper Saddle River: Pearson Education.
- Drucker P (2009). *Concept of the corporation*. New Brunswick: Transaction publishers.
- Eisler R, Carter S (2010). Transformative leadership: From domination to partnership. *ReVision* 30(3-4):98-106.
- Faeste L, Hemerling JE (2016). *Transformation: Delivering and sustaining breakthrough performance*. Boston, MA: Boston Consulting Group.
- Greenleaf RK (2003). *Servant leadership*. Mumbai: Magna Publishing Co.
- Grin J, Hassink J, Karadzic M, Moors EH (2018). Transformative leadership and contextual change. *Sustainability* 10:2159.
- Hamel G (2002). *Leading the revolution: How to thrive in turbulent times by making innovation a way of life*. New York: Harvard Business School.
- Hammer M, Champy J (2006). *Reengineering the corporation*. New York: HarperCollins Publishers.
- Imai M (2012). *Gemba kaizen*. New York: MacGraw Hill.
- Kaplan RS, Norton DP (1996). *The Balanced score card*. Boston, MA: Harvard Business Press.
- Keeney B (2010). N/om and transformative leadership. *ReVision* 30(3&4):51-56.
- Kouzes JM, Posner BZ (2012). *The leadership challenge*. San Francisco: Jossey-Bass.
- Langlois L (2011). Looking at transformative leadership through the concept of ethics. *Counterpoints* 409:87-99.
- McChesney C, Covey S, Huling J (2012). *The 4 disciplines of execution*. London: Simon and Schuster.
- Mckinsey and Company (2016). *Organization agility and organization design*. Available at: <https://www.mckinsey.com/~media/McKinsey/Business%20Functions/Organization/Our%20Insights/McKinsey%20on%20Organization/McKinsey%20on%20Organization%20Agility%20and%20Organization%20design.ashx>
- Mohanty RP, Lakhe R (2008). *Tqm in the service sector*. Ahmedabad: Jaico Publishing House.
- Montgomery CA (2013). *The Strategist*. London: Harper Collins.
- Montuori A (2010). Transformative leadership for the 21st century: Reflections on the design of a graduate leadership curriculum. *ReVision* 3(4):4-14.
- Montuori A, Donnelly G (2017). Transformative leadership. In Neal J (ed.), *Handbook of personal and organizational transformation*. Springer International Publishing.
- Nation Newspapers. (2013). *Transformative ceos with golden hands*. The Sunday Nation.
- Ncube LB (2010). Ubuntu: A transformative leadership philosophy. *Journal of Leadership Studies* 4(3):77-82.
- Peters T, Waterman RH (2004). *In search of excellence*. London: Profile Books.
- Rogers EM (2003). *Diffusion of innovations*, 5<sup>th</sup> ed. New York: Free Press.
- Senge P (2006). *The fifth discipline: The art and practice of the learning organization*. New York: Crown Publishing.
- Shields CM (2011). Transformative leadership: An introduction. *Counterpoints* 409:1-17.
- Vision 2030 Delivery Secretariat (2007). *About Vision 2030*. Available at: <http://vision2030.go.ke/about-vision-2030/>
- Wren DA, Bedeian AG (2009). *The evolution of management thought*, 6th ed. Hoboken, NJ: John Wiley and Sons.

**Related Journals:**

