Top Management Team Diversity, Quality of Decisions and Performance of Commercial Banks in Kenya

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ABSTRACT

There have been different findings as to whether Top Management Team Diversity affects the performance of organizations. Some past studies have found that the characteristics of the Top Management Team influence the performance of organizations while others have found that they do not. This study, which is founded on the Upper Echelon Theory, investigated the effect of TMT diversity on organization performance. Some researchers have suggested that top management characteristics, specifically their demographic characteristics could impair decision making and thus organization performance. As a result, the study sought to find out the effect of quality of decisions on the relationship between TMT diversity and the performance of commercial banks in Kenya. The target respondents were the Heads of Human Resources in all the banks and out of the 43 targeted banks, thirty three responded. The TMT diversity attributes under study were age, gender, academic qualifications, tenure in the bank and at the top, professional and functional background diversity while the balanced score card was used as the measure for performance. The study found that the quality of decisions have a significant effect on the relationship between TMT diversity the performance of banks.

Key words: Top Management Team Diversity, quality of decisions, organization performance

INTRODUCTION

Researchers have argued that in service industries like banks where competition is stiff and new players enter easily, there is a constant need to think strategically. According to Milliken and Martins (1996), diverse groups may make higher quality decisions. Organizational scholars (Cox, Lobel & Mclead, 1991) have illustrated that demographic characteristics of TMT have the potential to result in strategic decision making, greater creativity, more innovation and the ability to reach more and different types of customers, which is important in the banking sector. Proponents of diversity maintain that different opinions provided by diverse groups lead to quality decisions (Cox, 1993; McLeod & Lobel, 1992) as diverse teams are able to produce a wider range of solutions and decision criteria for strategic decisions.

Other researches however indicate that demographic variation signals variation in underlying and invisible cognitive processes. As a result, the decision making process by the Top Management Team can be a source of strife as many decisions are decided by majority vote. This type of decision often leads to ‘winners’ and ‘losers’. The significant potential for conflict within TMT
diversity can thus slow down the decision making process resulting to inability to remain competitive.

**Top Management Team diversity**

Carson et al., (2004) defined diversity as any attribute that humans are likely to tell themselves that another person is different from them while Miller, Linda and William (1998) defined the Top Management Team as all executives who report to the Chief Executive Officer or Chief Operating Officer. Researchers have categorized diversity in different ways.

The Top Management Team diversity discussed in the study is the extent to which the executive team is heterogeneous with respect to gender, age, academic qualifications, tenure, professional qualifications and functional back grounds. Simons, Pelled and Smith (1999) studied the same factors of TMT diversity with the exception of gender and professional qualifications.

Diversity is an increasingly important factor in organizational life as organizations worldwide become more diverse in terms of gender, race, ethnicity, age and other characteristics (Shaw & Barrett-Power, 1998). Bantel and Jackson (1989) concluded that when solving complex, non routine problems, groups are more effective when they comprise individuals with diverse skills, knowledge, abilities and perspectives.

**Organization performance**

Businesses today are faced with an increasingly competitive environment. To cope with this competition, organizations must be more adaptive. The performance of an organization can be measured in various ways. Other studies especially in the service sector have measured performance based on employee productivity (Orlando, 2000). This is an important performance criterion in banks because human labor costs are high and is calculated as the logarithm of net income per employee per year. This measure reflects employee efforts disassociated from variations in product and capital markets (Johnson & Packer., 1987).

Qualitative measures can be considered under outcomes which have affective (satisfaction, commitment, turnover, role conflict and group social integration), cognitive (innovation, range of perspective, number and quality of ideas) symbolic (behavior of lower level employees) and communication (communication with group members) consequences. Comparative performance can be measured in terms of an organization’s current performance relative to other organizations in its industry in terms of product quality, employee morale, on time delivery, inventory management and employee productivity (Milliken & Martins,1996)

The Top Management Team understands that organizational measurement system strongly affects the behaviors of management and employees. The TMT also understand that traditional financial measures like return on investment and earnings per share can give misleading signals for continuous improvement and innovation (Kaplan & Norton, 1992). Kaplan and Norton (1992) thus introduced the concept of a Balanced Scorecard as a basis for a strategic
management system. This approach not only included financial and non-financial aspects but also blended business strategies into management systems.

**Quality of Decisions**

Top Management Teams make strategic decisions and the quality of these decisions influence organization performance. Quality decisions are the ones that consider all issues deserving thought with respect to the situation. They depend on thoroughness. Researchers have found that group process conflict is multi-dimensional in that cognitive conflict can improve decision quality, whereas effective conflict may weaken group relations by generating acrimony. Timely, high quality decisions that enjoy the understanding and acceptance of those who will implement them are the hallmark of an effective TMT. A team’s cognitive capability is related to its cognitive diversity as diversity provides a resource of capabilities upon which the team can draw when making complex decisions.

Research findings indicate that TMT with diverse capabilities make more innovative and higher quality decisions than teams with less diverse capabilities (Bantel & Jackson, 1989). However, the quality of decisions depends heavily upon the process that the group actually employs. Rigorous debate of different and opposing positions produces a synthesis that is qualitatively superior to either of the initial positions. If group members sense that their own interest are at risk, they may undermine, sabotage or delay implementation of the decision. Top Management Teams make strategic decisions by combining their diverse cognitive capabilities with an interactive process resulting in the byproducts, quality decisions and satisfaction.

**Upper Echelon Theory**

The Upper Echelon Theory has foundations in the concept of dominant coalition which suggests that ‘The human social biases, filters and idiosyncratic processes at the top of the organization substantially influence competitive behaviors’ (Hambrick, 1994). These competitive behaviors are likely to influence organization performance. In their 1984 theoretical paper on Upper Echelon Theory, Hambrick and Mason suggested that top management characteristics, specifically their demographic characteristics could impair decision making and thus organization performance.

One of the core fundamentals of Upper Echelon Theory is that demographic characteristics are tangibly intertwined to the psychological and cognitive elements of the executive orientation. In turn, TMT demographics are used as extended referents of executive orientation. The orientations, a direct result of demographic characteristics affect strategic choices and decisions and therefore have tangible effects on organizational outcomes (Carson et al., 2004).

**Organization performance**

According to Ongore (2008), organization performance can be measured using three main perspectives, namely Return on Assets (ROA), Return on Investment (ROI) and Dividend yield (DY). Following previous TMT researches, Simons et al. (1999), measured organization
performance using profitability and sales growth. Pitts (2009) used perceived performance in order to tap on to whether employees believe that their group performs well. In other research, performance outcomes are given as stock performance, productivity, profitability, quality and organizational survival rate.

The Top Management Team do not always rely on one set of performance measure as they have realized that no single measure can provide a clear performance focus on the critical areas of the business. The TMT wants a balanced presentation of both the financial and operational measures. As a result, Kaplan and Norton (1992) devised a “balance scorecard”, which is a set of measures that gives the TMT a fast but comprehensive view of the business. The balanced scorecard therefore allows managers to look at business from four important perspectives, namely, Customer, Internal Business, innovation and learning and Financial (Kaplan & Norton, 1992).

Customer Perspective: How a company is performing from the customer perspective is a priority to the Top Management Team. For existing products, lead time can be measured from the time the organization receives an order to the time it actually delivers the service to the customer.

Internal Business Perspective: This refers to the efficiency of an organization’s internal operations. It includes measures that spur innovation, development of new products, quality of products and services and improving internal processes. Learning and Growth Perspective: This measures how well an organization is able to adapt and improve. It also measures employee training and corporate culture attitudes.

Quality of Decisions

According to Gilmore (1998), decision making is an incremental, subsequent process which does not necessarily happen at one point in time. It is the most hypothesized intervening variable in discussions of executive diversity and organization performance (Fredrickson & Mitchell, 1984).

Schwenk and Valacich (1994) found that evaluating and critiquing, engaging conflicts about a task, yields better decisions in teams than when members avoid conflicts. Putman (1994) showed that explicit task disagreement helped group members better identify issues and encouraged group members to develop new ideas and approaches. Often, making quality decisions involves managers liaising and negotiating people outside the department or even the organization. Overall, making quality decisions requires managers who are proactive and well prepared rather than reactive managers sticking to past practices when they are no longer suitable (Gilmore, 1998).

TMT diversity, Quality of Decisions and organization performance

There are several arguments for or against the theory that diversity affects quality of decisions. Those for argue that diversity leads to disagreements on basic resources. When there are many disagreements surrounding an immediate opportunity or threat or a long range plan, TMT as a group and as individuals are aware of more issues, more ways of viewing each issue and more alternative courses of action (Bantel & Jackson, 1989; Wiersema & Bantel, 1992).
of the range of issues and options, the TMT can discuss them, commission relevant analysis and may hire consultants to help in areas of weak knowledge.

Academic and popular writing has suggested that decision quality is a highly influential process in Top Management Teams. In this process, team members look at an issue with a wide lens, considering multiple approaches, choice of action and multiple decision criteria (Simons et al., 1999). Members brainstorm about possible alternatives and systematically list the pros and cons without disputing the ideas of one another.

When making complex decisions, organizations must evaluate what is at stake in making the decision and also the parties involved. It involves planning and implementation. The planning stage involves diagnosis of what is wrong or needs to be changed, developed and refined— the initial problem identification. Before undertaking any analysis, it is important to identify a broad set of alternative directions for a strategic decision. The alternatives should be creative, comprehensive, significantly different and compelling and can be evaluated through individual idea generation and group brainstorming (Gilmore, 1998).

The next level involves managing the actual output of decision making. This turns strategies and plans into action in order to achieve set objectives. Proponents of diversity hold that differences among group members give rise to varied ideas, perspectives, knowledge and skills that can improve the ability to solve problems and accomplish their work (Polzer et al., 2002). Complex tasks require problem solving, have a high degree of uncertainty and have a few set procedures, while routine tasks have a low level of variability and are repetitive (Polzer et al., 2002).

Successful implementation involves the ability to be adaptable in order to respond to customers and competitors’ activities in times of change (Gilmore, 1998). Persistence and perseverance are necessary for continuous improvement in order to resist erosion from competitive behavior and maintain consistency to avoid slipping standards.

**Conceptual Framework**

The literature review indicates that there are several variables that affect the relationship between diversity of Top Management Teams and organization performance. The study tested the intervening effect of quality of decisions on the relationship between TMT diversity and organization performance. These interrelationships are captured in Figure 1, a model depicting the conceptual framework for the study.

**Figure .1: Conceptual Model of the effect of quality of decisions on the relationship between Top Management Team Diversity and Organizational performance**

**METHODOLOGY**

The study was a cross sectional survey. These are surveys which target the entire population under study while case studies target a tiny minority in a sample. Cross sectional surveys are
descriptive in nature and may support inferences of cause and effect. The focus of this study was the effect of quality of decisions on the relationship between Top Management Team diversity and the performance of commercial banks in Kenya. These banks are different in sizes and ownerships thus the research design enabled capture information on all the banks at the same time. Cross sectional studies, which represent the whole population, have been found to be robust in relationships studies (O’Sullivan & Abela, 2007).

A list of all commercial banks operating in Kenya was obtained from The Central Bank of Kenya Annual Report, 2010 which indicated that there were 43 commercial banks as at December, 2010. The banking sector consists of both multinational banks and local banks operating mainly in urban areas while others have branches in other parts of the country. The research targeted the Heads of Human Resources or equivalents who have insights on TMT diversity, diversity management strategies and organizational culture of their banks.

The research used both primary and secondary data. The primary data focused on information on the four perspectives of the balanced scorecard while the secondary data focused on the Top Management Team characteristics. The primary data was collected using a semi structured questionnaire. The study used scales previously used by Fredrickson (1984) and Miller et al. (1998) to measure the intervening variable, quality of decisions.

The reliability of the instrument was estimated using Cronbach’s Alpha Coefficient which is used to assess the internal consistence or homogeneity among the research instrument items. The test provided a Cronbach Alpha of .861 which is good according to Nunnally (1978).

Validity is the degree to which results obtained from the analysis of the data actually represent the phenomenon under study (Mugenda & Mugenda, 2003). This study used face validity where a panel of experts gave their input as to whether the instrument met the criterion.

RESULTS
Simple regression analysis was used to determine the effect of TMT diversity on organization performance and on the effect of quality of decisions on organization performance while multiple regressions was used to determine the effect on quality of decisions on the relationship between TMT diversity and organization performance. The Top Management Team diversity under study was gender, age, tenure in the bank service, tenure at the top management, academic qualifications, professional qualifications and functional background.

For the purpose of the study, quality of decisions was made up of the factors taken into account when determining the cause of a major problem, when generating alternatives to solve problems and the when arriving at the final decision. Organization performance was composed of the four perspectives of the balanced score card, namely, financial, customer, internal business processes and learning and growth.
The results of the regression analysis are presented in Table 1 below:

<table>
<thead>
<tr>
<th>PREDICTOR VARIABLES</th>
<th>DEPENDENT VARIABLE (ORGANIZATION PERFORMANCE)</th>
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<td></td>
<td>B</td>
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<tr>
<td>Top Management Team Diversity</td>
<td>-0.317</td>
</tr>
<tr>
<td>Quality of Decisions</td>
<td>2.012</td>
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<tr>
<td>TMT X Quality of Decisions</td>
<td>1.999</td>
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R Squared = 0.010, F = 0.285
R Squared = 0.271, F = 12.877
R Squared = 0.319, Change in R Squared = 0.309, F Change = 12.271

**p < .001

The results in Table 1 above show the effect of TMT diversity on organization performance, quality of decisions on organization performance and the combined effect of TMT diversity and quality of decisions on organization performance. When TMT diversity was regressed on organization performance, the value of R² was 0.010 which means that the factors making up TMT diversity can only explain 1 percent of organization performance which was not significant. When quality of decisions was regressed on the organization performance, R² = 0.271 meaning that quality of decisions can explain 27 percent of the outcome while F = 12.877. The beta value = 2.012 at p < 0.001, which is significant.

The combined effect of quality of decisions and TMT diversity on organization performance improved with R² increasing from 0.010 to 0.319, an increase of 0.309 which was significant at p < 0.001. This indicates that the combined model can explain 31 percent of the outcome up from 1 percent given by the Top Management Team diversity alone, an increase of 30 percent. The Durbin-Watson score was at 1.953. Further, the F-factor improved from 0.285 to 12.271, which was significant at p < 0.001.

The beta coefficient results of the combined effect of TMT diversity and quality of decisions on organization performance were β = 0.565 at p < 0.001 up from β = -0.100 which is an increase of 0.665. We can therefore conclude that when quality of decisions was introduced to the relationship between TMT diversity and organization performance, the effect was significant.

We can conclude the TMT diversity has an insignificant effect on organization performance while quality of decisions has a significant effect on organization performance. When quality of decisions and TMT diversity are combined and regressed on organization performance, the effect
is significant. We can therefore conclude that an quality of decisions has a significant moderating effect on the relationship between TMT diversity and organization performance.

DISCUSSION OF FINDINGS

The results showed that there was no significant effect of Top Management Team diversity on organization performance. Past studies have indicated that observable attributes draw biases, discrimination and prejudice, because people like identifying with those who are similar to them. Research has shown that in a situation where one has the opportunity to interact with a number of different people, he or she is most likely to select a person who is similar to them (Burt & Regans, 1997).

In some past studies, TMT diversity was related to organization performance, without considering the mediating effect of process variables. Diversity effects on firm outcomes may however be too weak to be detected consistently and more so in cross sectional studies (Miller et al., 1998). As a result, this study used the quality of decisions to determine the intervening effect on the relationship between TMT diversity and organization performance. When TMT diversity was combined with the quality of decisions, the effect on organization performance was statistically significant meaning that quality of decisions has an intervening effect on the relationship between TMT diversity and organization performance.

Many researchers’ believe that diverse teams use their experiences and different backgrounds to communicate to each other. Other researchers have however suggested that this differentiation may lead to communication failure. From the findings of this study, organizations need to encourage diverse TMT to have meetings which identify the causes of major problems as such forums provide an opportunity for generating many options through the brainstorming process. Further, it allows information sharing and allocation of the desired resources. During their meeting, the diverse TMT members are likely to enhance communication and come up with new ideas to improve the bank services.

The banking sector in Kenya has expanded its networks very rapidly within the last four years. Some banks have used the expansion strategy to transform from small time players to large one-stop financial institutions. One bank is known to have opened 35 new branches across Kenya in 2008, using the expansion strategy to meet the customer demands. Several banks have recently expanded to neighboring countries including Southern Sudan, Tanzania, Uganda and Rwanda to enhance their revenue base.

CONCLUSION AND RECOMMENDATIONS

This study was motivated by an interest to find out how diversity of the Top Management Team affects performance of banks in Kenya. Past empirical studies on TMT diversity- organization performance have given mixed results.
It is generally believed that a mix of TMT characteristics is good for organization performance but the results of the study show otherwise which clearly indicates that the biases, conflicts and communication barriers which come along in diverse teams contribute negatively to the performance of banks in Kenya.

The use of quality of decisions was found to have a significant effect on the relationship between TMT diversity and performance of organizations. We can further conclude that different moderating variables have varying influence on the relationship between TMT diversity and organization performance. From the results of the study, banks whose diverse TMT take time to make quality decisions have better performance.

Diverse TMT, therefore need to involve the people directly impacted by decisions, make use of external experts and always try to determine the cause of problems while making decisions. In addition, use of historical data, brain storming and generation of many alternatives need to be encouraged while the diverse TMT is making decisions. Finally, the TMT needs to take into account the divergent views and have contingency plans, ensuring that the decisions arrived at are implemented promptly as this will result to better performance.

**Limitations of the study**

Issues relating to diversity are very sensitive especially in the Kenyan context. The first major challenge in undertaking this study was to convince the Heads of Human Resources to fill in the questionnaire. The area under study, TMT diversity and the performance of banks draws a lot of emotions and suspicion. The field of diversity is known to cause civil strife or conflicts if not well manage. There is a lot of talk in Kenya today about affirmative action and asking the Heads of HR to facilitate data on the composition of their TMT was initially a challenge as they may have felt that they were under evaluation. They however became relaxed and cooperative when they were assured that the data was for academic research.

Some respondents also refused to fill in the last part of the questionnaire which was asking for information on the composition of their Top Management Teams. These Heads of Human Resources argued that the information was confidential and thus they had no authority of releasing it without the authority of the individual TMT members. Fortunately, those who had a problem with directly releasing the information facilitated other published documents which had the same information, and as a result, the researcher was able to extract the required data. One bank however failed to facilitate either.

The Heads of HR were the respondents in the study. However, the TMT is composed of other functional heads who did not participate in the study. A wider participation of TMT from other functions may have given different results, thus this is a limitation in the study.
Implications of the study For Theory, Policy and Practice

The current study confirms the mixed findings on the relationship between TMT diversity and performance. On theory, the study advances the Upper Echelon Theory which suggests that Top Management Team characteristics, specifically their demographic one could impair decision making and thus organization performance. This research also serves as a reference point for those studying the relationship between TMT diversity, quality of decisions and organization performance. Other researchers can test other moderators to this relationship to find out which ones have the most significant effect.

Past empirical research on the relationship between TMT diversity and organization performance had recommended further research on which variables moderate on this relationship. This study found that the quality of decisions has a significant influence on this relationship.

The government of Kenya is committed to have at least 30 percent presentation of any gender in public recruitments, promotions and appointments through gender mainstreaming in government policies, plans, budgets and programmes. The study shows the importance of how quality of decisions affects performance positively. The need to brain storm, generate many options, engage experts and make use of historical data add value in coming up with quality decisions. While making the final decisions, there is need to make contingency plans, compare several alternatives and promptly implement decisions in order to enhance the performance of the banks.

Suggestions for future research

We recommend future studies be undertaken where other moderating variables are used to determine the effect of TMT diversity on organization performance. We further recommend testing of different diversity variables, namely, race, physical disability, sexual orientation which were not focused on in the study. It will also be interesting to find out other intervening variables like innovation or creativity affect the relationship between TMT diversity and organization performance.

It would also be interesting to undertake a similar study in the public sector and more so in state corporations where a lot of emphasis has been put by the Kenyan government on affirmative action. The new Kenyan constitution states that no single gender should be represented at over 70 percent in recruitments, appointments and promotions. It would be interesting to find out how far this has been implemented in the public institutions and if it has had any significant contribution to performance using the Performance Contracts which are currently signed between the Government of Kenya and public institutions annually for almost ten years now.
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