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POLICY BRIEF

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THE CENTRE FOR RESEARCH ON FINANCIAL MARKETS AND POLICY®

Are Gender-diverse Banks Less Risk-averse? Evidence from the Kenyan Commercial Banks

Executive Summary

During the 2008 financial crisis, banks faced blame for excessive risk-taking, prompting efforts by academics and regulators to understand and mitigate such behavior. Recent banking literature debates whether gender diversity on executive boards can curb risk-taking, drawing from cognitive psychology and behavioral economics suggesting women are more risk-averse. This hypothesis, explored extensively in non-bank firms, gained attention in banking recently. In Kenya, a study spanning 2010-2022 found women held about 19% of bank board seats, improving from 13% to 26%. Analysis of 21 banks revealed those with more women on boards exhibited less risky behavior, suggesting a link between gender diversity and stability. These findings suggest regulators could reduce risk-taking by mandating gender quotas on executive bank boards, underscoring the importance of diversity in banking governance.

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1. Context and Importance

The collapse of Lehman Brothers (a large U.S investment bank) in the wake of the 2007-08 Global Financial Crisis (GFC) is often touted as a symbol of excess bank risk-taking. The bank built a bubble through its business in subprime mortgage lending which eventually bust sweeping through the global financial markets and ultimately costing an estimated $10 trillion in lost economic output. In the aftermath of this dramatic collapse of Lehman Brothers, Neelie Kroes, a one-time European Union Commissioner for Competition, famously said, that if Lehman Brothers had been 'Lehman Sisters,' the GFC would not have happened as it did. Her rationale was that women are less risk-taking, less obsessed with money and status and generally less full of themselves than men and would have given different perspectives than their male colleagues.

Indeed, there are many experimental and survey-based studies which document that, women are more risk-averse than men. This expansive literature offers some interesting explanations on this observed gender differences in risk preferences. Given that this literature is huge I only single out three propositions. The first explanation of the gender differences in risk-taking point out to the different ways in which men and women experience emotions. More specifically, women report more nervousness and fear in the face of potentially negative situations. Accordingly, women derive lower utility from negative outcomes, and this explains their elevated risk-aversion tendencies. Additionally, the psychology literature document that, in identical challenging situations, women tend to feel fear while men tend to feel anger [6]. This literature further argues that when individuals are angry, they tend to positively assess future gambles, while individuals who are afraid, tend to pessimistically assess future risky situations. Thus, emotional perceptions of gambles, provides an explanation of the gender differences in risk attitudes.

The second explanation has been christened in the psychology literature as the challenge-threat view [3]. This view argues that there are differences in how men and women respond to a risky situation. Men on one hand, view a risky situation as a challenge that calls for action, women on the other hand, interpret a risky situation as a threat to be avoided. The author argues that these differences spring from the differing motivations between men and women. For example, men are mostly stimulated by challenging, ego-centric environments while women are not.

The third explanation features what is now known in the psychology literature the as the approach/inhibition theory of power (AITP) which posits that individuals who possess power tend to focus primarily on positive outcomes (approach behavior) while individuals with less power focus their attention on avoiding negative outcomes (inhibition behavior). Further, conflict theories view women as the constituent with less power [1]. This gender discrimination, embedded in many societies, stems from the view that access rights to resources tend to be held dominantly by the male gender [2]. In the context of risk-taking therefore, the approach/inhibition theory of power would predict that female directors (assumed to be less powerful) will focus on the negative attributes of risky activities hence undertaking less risky strategic decisions, while men (assumed to be more powerful) will focus on the positive aspects of risk-taking and so undertake excessive risk.

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Empirical studies on the relation between gender diversity and bank risk-taking has to date produced admixture results. Some conclude that women directors largely undertake less risk while several other studies do not find any significant gender differences in risk-taking. There is some recent line of argument that women who rise to the top echelon in financial firms have similar risk-aversion levels as their male counterparts. A recent study conducted in the US banking industry finds no significant risk preferences across male and female directors in bank boards. The study therefore rejects the claim that board gender diversity is an effective tool of curtailing excessive bank risk-taking in the U.S. In view of the mixed results documented so far, there is still a gap for empirical studies on this subject. The current policy brief highlights the results of a study conducted in the context of the Kenyan banking industry to ascertain the connection between board gender diversity and risk-taking behavior.

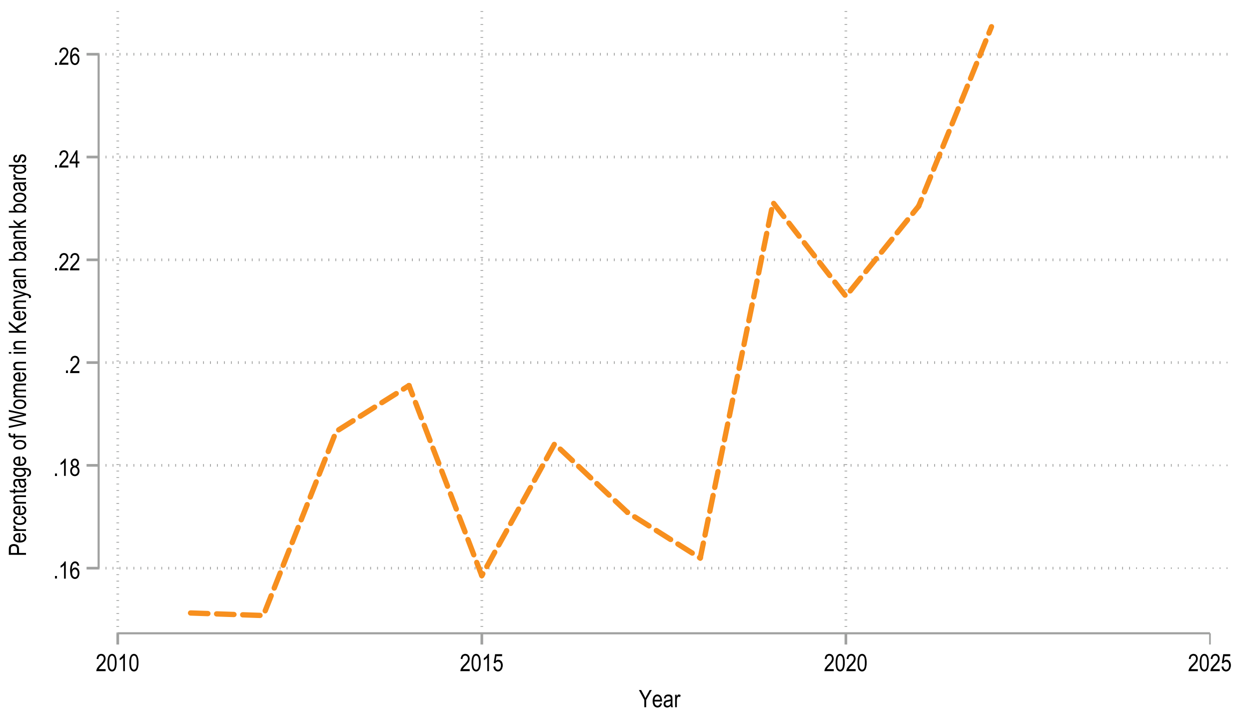
2. Data and Methods

The study underlying this policy brief employs annual bank data for the period 2010 to 2022. It is widely recognized in the corporate finance literature that the relationship between corporate governance (such as board diversity) and firm performance is dynamic in nature. In view of this, appropriate dynamic panel methods are employed to investigate the role of board gender diversity on bank risk-taking behaviour. As a baseline, board gender diversity is measured as a simple ratio of the number of women to men in banks' executive boards. However, to check the robustness of the findings, some other measures that capture the variety and balance aspects of gender diversity are employed. Similarly, since bank risk-taking is not directly observable, several proxies are employed in the study. Particularly, measures used include the non-performing loans ratio (which measures ex post risk-taking), the deposit-to-loans ratio which measures the extent to which a bank prefers to hold deposits rather than lend out the amount. This ratio is closest to measuring risk-taking behaviour. For example, if indeed women directors are risk-averse, then we should observe banks with more women directors holding more deposits relative to loans. Yet another measure of risk-taking employed are the Z-score which is a measure popularly used to measure how far a bank is from default. It therefore gauges the stability of a bank.

3. Results

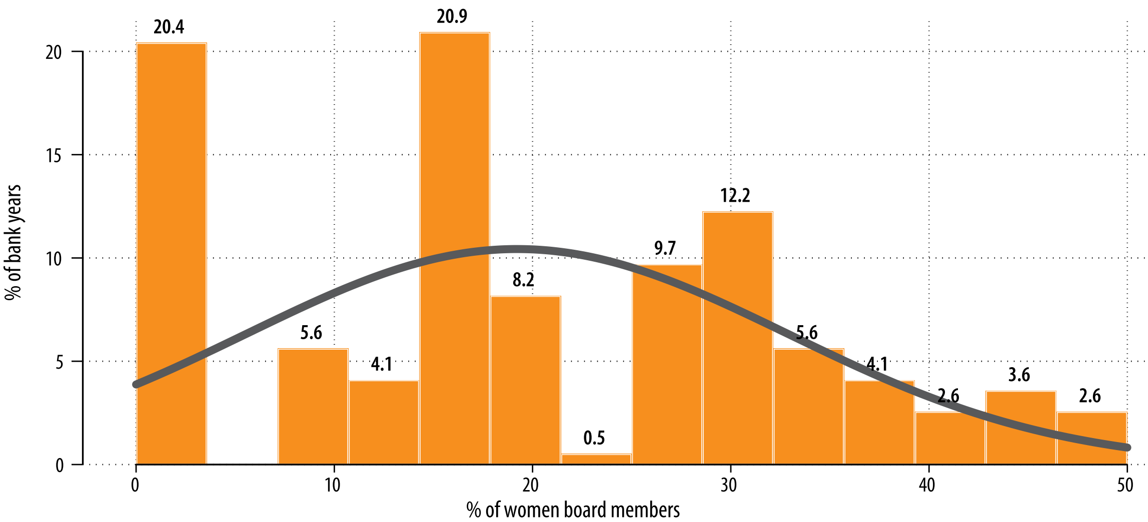
A careful empirical study of the Kenyan bank data over the period 2010 t0 2022 uncovers two key findings. Firstly, the average proportion of women directors in Kenyan bank boards is about 19%. Although relatively low, this percentage is better compared to the percent of women who hold bank board seats in Europe and US. For example, a study of a large sample of European banks [7] show that women hold a paltry 7.5% of bank board seats while in US only 12% of women hold bank board seats [1]. A notable exception is Russia, where the percentage is about 30% [5] and Italy 31% [8]. Secondly, the participation of women in Kenyan bank boards has been growing steadily over the sample period. The average annual representation doubled over the period 2010 to 2022 (from 13% to about 26%) (see **Figure 1**).

Figure 1: **Gender diversity in Kenyan bank boards (2010-2022)**



Source: Kenyan Banks' annual corporate governance reports

Figure 2: Distribution on women representation on bank boards (2010-2020)



Source: Kenyan Banks' annual corporate governance reports

Thirdly, there is a considerable heterogeneity across banks in terms of board gender composition. **Figure 2** illustrates the distribution of women representation in executive boards of the sampled banks. The figure shows that about 20% of the sample observations feature zero women representation in executive boards of banks. Further approximately 50% of the banks have between 10% and 30% female board representation. About 18% of the sampled banks have more than 30% of their board members being female.

Lastly, banks with more women in their boards are associated with low risk-taking. Specifically, gender-diverse banks tend to have low credit risk (as measured by NPLs), are more stable, liquid and have low risk-weighted assets.

4. Policy Recommendation

The results of this paper have one key policy recommendation. Since this study shows that female directors in banks' boards promotes less risky strategies and promotes a stable banking system in line with shareholders' interests, regulators can curtail excessive risk taking by imposing gender quotas in executive bank boards.

5. Works Cited

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