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Key Finding

Given the increased social pressures for diverse boards, minority status has become a valuable asset that shields female and ethnic minority directors from labour market penalties when they are associated with negative performance.

Business Application

The board of directors is a critical element in a firm's performance. Managers, boards and regulators need to understand the social elements that shape the labour market for directors.

A key factor that drives directors' reputations and recommendations for board appointments is the performance of the firms on which they have served. Much of the literature maintains that corporate outcomes provide signals to the labour market about directors' quality. The process is as follows: board members who are associated with better corporate outcomes attain better reputations and are invited to serve on more boards, whereas directors who are associated with negative corporate outcomes (e.g. directors who serve on a firm that engages in fraud) attain negative reputations, experience higher dismissal rates and negative career prospects.

Considering the growing social trend for firms to adopt diversity goals and add women and ethnic minorities to their boards, my co-authors and I provide evidence that directors' minority status has become a valuable asset that shields them from reputational penalties resulting from their negative performance. Specifically, we analyse the labor market penalties directors face as a result of their association with corporate fraud. We find an unexpected outcome: the social pressure for board diversity has affected the labour market for directors to the point where women and ethnic minorities who serve on the boards of firms accused of corporate fraud experience significantly lower labor market penalties relative to white men. We compiled a comprehensive dataset of US firms accused of accounting fraud and 4,350 individual directors, and found that women and ethnic minorities lose significantly fewer board seats compared to white men, even when they are members of the audit committee. Furthermore, this reputational immunity becomes more pronounced when social pressures for board diversity intensify, and when minority directors are perceived to be in short supply.

Our study suggests that the social elements shaping the market for directors are complex and offers new insight into why and when women and ethnic minorities experience reputational immunity. Such deeper understanding of the effects of social pressure for diversity advances theory and offers practical insights into the implications of diversity initiatives for facilitating fairness and enhancing organisational performance.

Read more: Naumovska, I., Wernicke, G. and Zajac, E., (2017). Unsettling Settling-Up? Corporate Fraud and Heterogeneity in the Reputational Penalties to Directors. *Academy of Management Proceedings* (1).

Ivana Naumovska is an Assistant Professor of Entrepreneurship. She studies how social dynamics shape financial markets and how managers can and do leverage these relevant properties of the financial market arena. To know more, visit her website.

Research interests: social influences on financial markets, corporate fraud, reverse mergers and special purpose acquisition companies.