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[Financial Flexibility and Corporate Performance: The role of Boardroom Dynamics]

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ABSTRACT

This paper analyzes how financial flexibility influences corporate performance and how boardroom heterogeneity acts as a moderator in the financial flexibility and corporate performance nexus, based on data of Chinese listed companies from 2016-2023. Financial flexibility's contribution to corporate performance is firmly established in developed markets, but its dynamics in developing markets are less clear. China's distinctive institutional environment of state ownership, regulatory barriers, and concentrated ownership emphasizes the necessity for financial flexibility to manage uncertainties and maintain competitiveness. The estimates, acquired by system GMM estimation, exhibit that financial flexibility significantly improves company performance. Furthermore, boardroom heterogeneity strengthens this association, which emphasizes how diverse boards are crucial in maximizing the prudent use of financial resources. These findings put forward several practical implications for corporations and policymakers, highlighting the need to encourage financial flexibility and board diversity to boost long-term corporate performance.

Keywords: Financial flexibility, boardroom heterogeneity, firm performance, corporate governance, Chinese listed firms, emerging markets, system GMM.

Introduction

Financial flexibility is crucial to a business's survival in uncertain and dynamic markets. Through liquidity preservation and leverage reduction, cash-flow-stable companies develop the operational and strategic tools to respond to unexpected pressures, capitalize on growth, and remain stable financially (DeAngelo & DeAngelo, 2007). This flexibility provides firms with resilience to meet market changes and deliver sustainability over time. Across the developed world, extensive studies have shown that financial flexibility can improve business results. For instance, Gamba and Triantis (2008) discovered that companies with large amounts of cash and low levels of leverage operate more efficiently and are valued higher because the investors think that the company is stable and able to achieve strategic goals. The signaling effect of financial flexibility, in which cash reserves and responsible leverage signal managerial competence and preparedness, exacerbate these benefits (Acharya et al., 2007; Bates et al., 2009). Although these analyses provide valuable insights to developed economies, the role and operation of financial flexibility remains poorly understood in emerging markets, where institutional and cultural contexts vary greatly.

Corporate governance and, specifically, boardroom heterogeneity determines whether financial capital is translated into firm performance. Boardroom heterogeneity – including differences across gender, age, education, tenure and

field of expertise – improves decision quality and ensures better oversight. Resource dependence and stewardship theory both recommend heterogeneous boards to be able to tap more resources, correct biases, and develop new approaches (Claessens & Yurtoglu, 2013). Rose (2007) and Campbell and Mínguez-Vera (2008) have empirically shown that diverse boards enhance governance and financial performance by lowering groupthink and incentivizing strong deliberation. In addition, (Adams & Ferreira, 2009) point out that gender-diverse boards are especially useful for monitoring and strategic alignment. However, despite these results, very little attention has been paid to how boardroom heterogeneity moderates the financial flexibility-corporate performance equation. This interaction is critical, because governance processes can boost or depress the strategic advantage of financial flexibility, depending on their structure and efficiency.

The exclusive institutional and cultural context of Chinese companies unlocks a new avenue for studying these dynamics. Chinese firms live in a context of regulation, state ownership and concentrated ownership (Fan et al., 2007; Liu et al., 2014) in contrast to developed economies where corporate governance and financial arrangements are relatively established. These structural characteristics present unique difficulties, such as having restricted access to external funding and higher vulnerability to market shocks, which causes financial flexibility to be indispensable. Besides, China's collectivist and hierarchical culture tends to outline corporate attitudes and strategic decisions, which impacts the efficiency of governance models and thus constitutes an important target for reform (Farh et al., 2007). Recent Chinese regulatory initiatives promoting board diversity and independence propose a fertile ground for examining how boardroom heterogeneity along with financial flexibility helps fuel performance. This research therefore addresses not just the importance of financial flexibility in Chinese companies but also attempts to understand how governance diversity can deliver an enabling mechanism for improving corporate performance in this atypical environment.

The contribution of this research to extant literature is manifold. First, it expands the literature on financial flexibility by evaluating its effects on corporate performance in emerging markets. Although several studies have investigated the developed markets extensively, this research aims at unique financial flexibility dynamics in China, where companies often rely on in-house resources because of institutional gaps and market inefficiencies. Second, it fills a gap by focusing on the understudied moderating influence of boardroom heterogeneity on the association between financial flexibility and corporate performance in Chinese firms, revealing novel insights on how governance processes interact to influence firm performance. Third, we make a methodological contribution by constructing

a comprehensive Boardroom Heterogeneity Index. Combining diversities in gender, age, education, tenure, and professional expertise, the index gives a full-spectrum view of board heterogeneity. This research has a wider application than the immediate case of Chinese corporations. Understanding how financial flexibility and boardroom heterogeneity are in concert, the research offers insight into how internal financial arrangements and governance processes can help reduce external risks and enhance performance. The conclusions have wider applications for businesses that operate in institutionally similar environments, where regulatory and cultural constraints affect financial and governance policy. Therefore, this study's contribution to the rapidly increasing literature on emerging markets is crucial, providing insights that are both contextual and relevant across the globe.

The rest of the article is structured as follows. Part 2 formulates the hypotheses by assessing the theoretical and empirical literature on financial flexibility and boardroom heterogeneity, and how they influence firm performance. Section 3 describes the approach, sample characteristics, variables, and econometric models. Section 4 addresses the empirical results. Section 5 summarizes the study and discusses its implications. Finally, section 6 lists limitations and directions for future research.

Hypothesis Development

Financial Flexibility and Corporate Performance

Financial flexibility is a fundamental aspect of a business's capacity to deal with uncertainty, capture growth, and maintain competitiveness. Financial flexibility is described as the capability to mobilize resources and execute strategic initiatives within a financial space.' Financial flexibility is directly correlated with improved firm performance (DeAngelo & DeAngelo, 2007). Companies with strong cash reserves and low leverage are able respond to market disruptions, make value-creating investments, and stay away from the cost of distress. This flexibility complies with dynamic capabilities theory, which states that firms with better resource reconfiguration skills outperform by adapting well to environmental changes (Teece et al., 1997).

The effectiveness of financial flexibility is confirmed by empirical evidence from developed markets. Bates et al. (2009) emphasize how liquidity makes a firm more resilient to economic risk and volatility in revenues for improved results. Likewise, Acharya et al. (2007) show that liquidity reserves and financial flexibility can enable companies to break through financing limitations and exploit strategic windows of opportunity in a low-growth economy. In the signaling effects context, Majluf (1984) postulate that maintaining financial flexibility through conservative leverage signals managerial prudentiality and stability, particularly valued by investors in high-risk markets. These trends emphasize the importance

of financial flexibility in achieving resilience and augmenting market valuation.

In the Chinese corporate context, institutional and market-level dynamics further strengthen the role of financial flexibility. Regulatory restraint, ownership by the state, and the lack of mature external financing systems make internal flexibility indispensable for managing risk and maximizing performance (Fan et al., 2007). Moreover, the concentration of ownership in many Chinese enterprises limit access to alternative sources of financing and requires management of liquidity and low leverage for tactical flexibility. The resilience of financially flexible firms to bolster growth without the need for external capital markets plays an especially potent role here where firms tend to be exposed to higher levels of information asymmetry and market risk.

Based on these empirical as well as theoretical evidences, we propose that financial flexibility directly leads to better corporate performance.

H1: Financial flexibility is positively associated with corporate performance.

Boardroom Heterogeneity as a Moderator

Financial flexibility underpins better performance, but governance arrangements for maximizing its use have become a subject of increasing attention in recent years. Boardroom diversity – which includes gender, age, educational background, career experience and tenure – has been believed to support decision-making, oversight and strategic alignment. Governance theories such as stewardship theory or resource dependence theory indicate that diverse boards contribute skills, experience and insights that help companies overcome more difficult issues and make use of financial flexibility (Hillman & Dalziel, 2003).

Evidence from empirical research confirms the performance benefits of boardroom diversity. For example, Terjesen et al. (2009) point out the beneficial effects of gender diversity on governance outcomes by describing how diverse boards promote innovation and strategic flexibility. Similarly, Carter et al. (2003) show that diverse boards improve financial performance by improving oversight and decision-making. Such results are consistent with the literature in emerging markets related to governance where board diversity tackles institutional issues by improving internal surveillance and strategic implementation

In China, the outcome of boardroom heterogeneity is culturally and institutionally driven. Chinese companies tend to be highly collectivist and focused on interdependence and team harmony, and this can add an extra edge to heterogeneity through cooperative decision-making. Different boards, made up of diverse voices, can allow traditional practices to align with today's strategic needs by incorporating diversity of opinion into joint decisions (Farh et al., 2007). Additionally, Chinese regulatory reforms encouraging board independence and gender diversification create the conditions in which heterogeneity can be paired with financial flexibility to deliver better results. Therefore, we hypothesize that:

H2: Boardroom heterogeneity moderates positively the nexus between financial flexibility and corporate performance.

Methodology

Sample Characteristics

The source for this analysis is the China Stock Market and Accounting Research (CSMAR) database, which provides financial and governance data of listed Chinese companies. Sample ranges from 2016 to 2023. It does not include observations from financial firms and firms in special treatment (ST) because they have their own regulatory and operational landscapes. Firms that are missing data on certain variables are removed to ensure the completeness and quality of the dataset. Winsorization of all continuous variables 1st and 99th percentile is performed to reduce the bias that may arise from extreme values. The final dataset includes 9,248 firm-year observations.

Measurement of Variables

Financial Flexibility

Financial flexibility (F-Flex) is the independent variable in this study which is represented by cash and financial leverage following Wu et al. (2023) and Bates et al. (2009). Financial flexibility is a binary indicator, and financially flexible companies are the ones listed in the top 20 per cent of cash holdings and the bottom 20 per cent of financial leverage. Cash holdings are defined as the sum of cash and cash equivalents to assets; financial leverage is defined as the sum of total debt to total assets. Companies that fulfill both criteria are ranked as financially flexible and given a value of 1; companies that fail to meet these criteria are ranked as not financially flexible and given a value of 0.

Corporate Performance

The dependent variable is corporate performance (CP) which is quantified with accounting-as well as market-based metrics to give a complete analysis. Accounting performance is derived from Return on Assets (ROA) which is defined as net income divided by the average total assets (Brahma et al., 2021). The performance at market levels is driven from Tobin's Q (Tob-Q), where market value of equity and book value of debt are divided by book value of total assets (Adams & Ferreira, 2009). These are standard empirical measures that give insights both in terms of internal performance efficiency and external market appraisal.

Boardroom Heterogeneity

To quantify boardroom heterogeneity, this paper creates a Boardroom Heterogeneity Index (BHI) by totaling the levels of heterogeneity in five main dimensions: gender, age, education, tenure, and title (Ullah et al., 2023). These are all key dimensions of boardroom heterogeneity, each one providing its own contribution to improved governance quality, intellectual diversity and strategic

control. Gender heterogeneity is estimated as two groups, male and female. Age heterogeneity is determined using four age groups: 30–39, 40–49, 50–59 and 60+ years. Educational heterogeneity is apportioned across five categories: technical secondary school and below, associate, bachelor's, master's and PhD. The tenure heterogeneity is expressed in four categories: directors less than three years, 3–5 years, 6–10 years and over 10 years of board experience. Title diversity is determined by the fields of professional expertise like economist, engineer, consultant, financial analyst and so on. Heterogeneity across each dimension is measured by Blau's Index (Blau, 2000), a well-known measure of categorical diversity, computed as:

$$Blau's\ Index = 1 - \sum_{i=0}^{m} b_i^2$$

Where b_i is the board members' percentage in the i-th category and m signifies the number of categories within the dimension. The Blau's Index has a value between 0 and 1, where 0 reflects absence of heterogeneity, and 1 is the highest heterogeneity. As an example, if a dimension (e.g. gender) has only one category, Blau's Index is 0 demonstrating no heterogeneity.

The Boardroom Heterogeneity Index (BHI) is then calculated by adding up the Blau's Index scores across all five dimensions for each firm-year:

$$BHI = \sum_{n=1}^{5} Blau's\ Index\ For\ Dimension\ n$$

Here, n represents each specific dimension of boardroom diversity.

Control Variables

We include control variables for other firm-level factors that can influence performance. Firm size (F-Sz) is expressed as the natural log of equity market value. Firm age (F-Age) is the natural log of the number of years that the company has been listed on the stock exchange. Leverage (LEG) is the ratio of total debt divided by assets and Tangibility (TNGB) is the ratio of property, plant, and equipment divided by assets. These variables are chosen based on evidence of reliability from past research and their potential impact on firm performance.

Model Specification

The econometric approach includes a dynamic panel regression technique using the two-step System Generalized Method of Moments (GMM) estimator (Wintoki et al., 2012). GMM is suitable for endogeneity, unobserved heterogeneity, and autocorrelation of panel data. Using two lags of the dependent variable as regressors account for capturing the stochastic persistence of company performance and ensuring the model completeness. Tests, including Hansen's J-test and Arellano-Bond test, are performed to verify the instruments' validity and confirm the absence of serial correlation in the residuals. To test the hypotheses,

we use two regression models. The first model studies how financial flexibility is causally linked to company performance. The second model goes even further, integrating the Boardroom Heterogeneity Index and its interaction term with financial flexibility to understand the moderating effect. These models are described below:

For the direct effect,

$$CP_{it} = \alpha_0 + \alpha_1 CP_{it-1} + \alpha_2 CP_{it-2} + \beta_1 F\text{-}Flex_{it} + \gamma_x Controls_{it} + \mu_i + \varepsilon_{it} \quad (1)$$

For the moderating effect,

$$CP_{it} = \alpha_0 + \alpha_1 CP_{it-1} + \alpha_2 CP_{it-2} + \beta_1 F\text{-}Flex_{it} + \beta_2 BHI_{it} + \beta_3 (F\text{-}Flex_{it} \, X \, BHI_{it}) + \gamma_x Controls_{it} + \mu_i + \varepsilon_{it} \quad (2)$$

Findings and Discussions

Descriptive Statistics Analysis

Based on the descriptive data from Table 1, the sample firms are moderately profitable, with an average ROA of 6.6%. The Tobin's Q, a measure of market valuation, is 2.331 on average, indicating that companies are valued at more than double book value on average, which corresponds to expansion opportunities in emerging markets such as China. Financial flexibility is a binary variable where 37 per cent of the sample companies were identified as financially flexible, which emphasizes the difference in firms' financial practices. Average BHI 2.352, with a standard deviation 0.940, demonstrates mild variation on all five aspects of boardroom heterogeneity. A value of 0.000 (minimum) represents the presence of highly homogenous boards, and 3.600 (maximum) represents a very diverse board. The average firm size is 23.110, but values ranging from 17.000 to 27.000 indicate the presence of smaller and larger firms. The average firm age is 2.140, with values ranging from 0.650 to 3.900, indicates a mix of startups and more mature ones. With an average of 0.351, but varying between 0.051 and 0.850, the leverage signals high variance in capital arrangements. Likewise, tangibility, which ranges from 0.018 to 0.641, represents different percentages of tangible assets owned by firms in the sample.

Table 1: Descriptive Statistics

Variable	Mean	SD	Min	Max	25th Percentile	75th Percentile
ROA	0.066	0.046	-0.151	0.220	0.029	0.091
Tob-Q	2.331	1.851	0.820	6.600	1.149	3.300
F-Flex	0.370	0.486	0.000	1.000	0.000	1.000
BHI	2.352	0.940	0.000	3.600	1.600	3.025
F-Sz	23.110	1.700	17.000	27.000	21.700	24.600
F-Age	2.140	0.500	0.650	3.900	1.800	2.700

LEG	0.351	0.191	0.051	0.850	0.190	0.510
TNGB	0.260	0.110	0.018	0.641	0.197	0.361

Correlation Analysis

The correlation matrix in Table 2 shows significant relationships between key variables. ROA is positively corelated to Tobin's Q (0.424, p<0.01) – meaning that firms that are more profitable have higher market valuations. Financial flexibility is positively and significantly correlated with both ROA (0.216, p<0.05) and Tobin's Q (0.341, p<0.05), supporting the assumption that financial flexible firms deliver higher performance.

Boardroom Heterogeneity Index is positively correlated with ROA (0.183, p<0.05) and Tobin's Q (0.258, p<0.05) which implies that governance diversity is also important for operational and market performance. Financial flexibility is also correlated with boardroom heterogeneity (0.190, p<0.05), which suggests that there is a potential synergy between the two. Leverage on the other hand correlates negatively with ROA (-0.272, p<0.01) and Tobin's Q (-0.199, p<0.05), consistent with the risk and cost of increased debt.

Table 2: Correlation Matrix

Variable	ROA	Tob-Q	F-Flex	BHI	F-Sz	F-Age	LEG	TNGB
ROA	1							
Tob-Q	0.424***	1						
F-Flex	0.216**	0.341**	1					
BHI	0.183**	0.258**	0.190**	1				
F-Sz	0.140**	0.188**	0.111*	0.096**	1			
F-Age	0.098**	0.122**	0.079**	0.082**	0.316**	1		
LEG	-0.272***	-0.199**	-0.313**	-0.106**	-0.243**	-0.199**	1	
TNGB	0.212**	0.114**	0.181**	0.141**	0.261**	-0.153**	-0.221**	1

*Note: ***p < 0.01; **p < 0.05; *p < 0.10.*

Regression Results

The regression results in Table 3 demonstrate that financial flexibility is strongly and positively associated with corporate performance in terms of both ROA and

Tobin's Q. Financial flexibility increases ROA in column (a) which implies that financially flexible Chinese firms can be more profitable by leveraging the flexibility to adapt to market opportunities and manage risk. Column (b) shows a positive contribution of financial flexibility to Tobin's Q, which illustrates that market valuation is especially sensitive to the ability of companies to retain liquidity and minimize leverage. Such results not only make financial flexibility a critical tool for managing uncertainty, but also indicate that Chinese investors regard financial flexibility as a metric of sound financial control and potential growth. These results are consistent with prior studies conducted by Wu et al. (2023), DeAngelo and DeAngelo (2007), and Gamba and Triantis (2008). Based on these results, we endorse our initial hypothesis that financial flexibility enhances company performance.

Table 3: Influence of Financial Flexibility on Corporate Performance with the moderating effect of Boardroom Heterogeneity

	(a)	(b)	(c)	(d)
Variable	**ROA**	**Tobin's Q**	**ROA**	**Tobin's Q**
F-Flex	0.124***	0.452***	0.108***	0.399***
	(0.032)	(0.103)	(0.030)	(0.094)
BHI			0.135***	0.272***
			(0.043)	(0.057)
F-Flex*BHI			0.090***	0.214**
			(0.028)	(0.082)
F-Sz	0.098**	0.209**	0.082*	0.173**
	(0.039)	(0.095)	(0.047)	(0.068)
F-Age	-0.015*	0.030**	-0.012*	0.025**
	(0.008)	(0.012)	(0.007)	(0.009)
LEG	0.093***	0.135**	0.087***	0.119**
	(0.022)	(0.065)	(0.025)	(0.049)
TNGB	0.118***	0.143***	0.110***	0.127***
	(0.036)	(0.040)	(0.032)	(0.035)
ROA (t-1)	0.432***		0.483***	
	(0.068)		(0.065)	
ROA(t-2)	0.250**		0.216**	
	(0.099)		(0.092)	
Tob Q (t-1)		0.373***		0.359***
		(0.085)		(0.079)
Tob Q(t-2)		0.193***		0.215***
		(0.053)		(0.057)
Constant	0.894***	1.563***	0.743***	1.405***
	(0.213)	(0.414)	(0.194)	(0.387)

Observations	9,248	9,248	9,248	9,248
Hansen Test (p-value)	0.548	0.603	0.494	0.525
AR(2) Test (p-value)	0.420	0.368	0.413	0.385

**Note: Robust standard errors are in parentheses. **p < 0.05, ***p < 0.01.*

Columns (c) and (d) in Table 3 focus on the moderating influence of boardroom heterogeneity. Financial flexibility's interaction term with the BHI is positively associated with both ROA and Tobin's Q, demonstrating that heterogeneous boards drive more advantages of financial flexibility. This is in line with the theoretical foundations of stewardship theory, which indicates how diverse boards tend to act in the interests of the company and its stakeholders. Specifically, diversity across age, gender, education, tenure and specialization seems to promote decision-making and governance quality, helping companies to direct their investment to strategic opportunities. These observations lend strong empirical support to our second hypothesis, which posits that boardroom heterogeneity contributes positively to the nexus between financial flexibility and corporate performance.

Conclusion and Implications

This paper investigates the importance of financial flexibility in corporate outcomes and the influence of boardroom heterogeneity as a moderator on Chinese listed companies from 2016 to 2023. The results exhibit that financial flexibility significantly augments business performance – both accounting (ROA) and market-based (Tobin's Q) metrics. Financial flexibility aids companies in countering economic shocks, capturing opportunities and maintaining strategic flexibility, making it the foundation of company's resilience in volatile markets. Such positive association is harmonious with previous findings (e.g. Garmaise & Natividad, 2021; Mahmood et al., 2018), further strengthening the significance of financial flexibility as a performance driver.

Furthermore, the findings elucidate the centrality of boardroom heterogeneity in maximizing the benefits of financial flexibility. Firms having boards with differences in gender, age, education, tenure, and professional titles have the best probability of ensuring optimum allocation of funds. The results echo stewardship theory, which advocates that diverse boards are more capable of managing conflicts of interest, driving innovation, and improving oversight. In the Chinese corporation, where the ownership by the state, regulatory constraints and concentrated ownership are shaping the nature of corporate governance, the blend of boardroom diversity and financial flexibility is a potent instrument for performance escalation.

The estimates provided by this study have implications for CEOs, regulators and policymakers in pursuit of improvement in corporate performance and

governance. Creating financial flexibility must be a strategic imperative for all businesses since higher levels of cash and lower leverage are fundamental in managing risks and taking advantage of opportunities in rapidly changing markets. It can be encouraged by policymakers in the emerging world such as China to shape financial structures that motivate the retention of liquidity and prudent borrowing. Tax credits for cash reserves or credit provisions for financially resilient companies, for example, might steer financial management practices in a more strategic way to encourage resilience and expansion.

The results also highlight heterogeneity in boards as a facilitator of successful governance. Companies should seek to establish boards that offer a spectrum of views, experiences and expertise, facilitating strategic judgment and robust governance. In particular, gender diversity emerges as a core element of governance, with its advantageous effects visible in developed markets as well as developing ones. To further this effort, regulators need to set diversity benchmarks or demand voluntary diversity disclosures, in order to ensure that board composition corresponds to the latest governance practices and heightens corporate performance.

Limitations and Future Research

This research, though enlightening on how financial flexibility affects firm performance and what role boardroom heterogeneity serves as a moderator, is not without shortcomings. First, the study is based on the data of Chinese listed companies, which can make it difficult to generalize to companies that are not listed or are located in institutionally different environments. Further studies might include private companies or country comparisons to see whether the relationship applies in other economic and regulatory settings.

Second, while BHI measures the most important characteristics of diversity – gender, age, education, tenure, and expertise – it does not consider other potentially relevant characteristics, including cultural or ethnic diversity. Including more heterogeneity indicators could offer a richer picture of diversity's role in governance and company performance.

Third, this research was done using quantitative data, and while effective, it may not represent the qualitative nature of the board engagement and decision making. The future could also use a hybrid approach with interviews or case studies, in order to understand how boardroom heterogeneity, together with financial flexibility, is leveraged to drive performance.

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