

TOP MANAGEMENT TEAM DIVERSITY AND COMPANY PERFORMANCE: THE MODERATING EFFECT OF ORGANISATION LIFE CYCLE

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ABSTRACT

The research paper examines the moderating impact of Organizational Life Cycle on the relationship between Top Management Team Diversity and Company Performance. The study first elaborates and establishes the theoretical link between organization lifecycle and composition of management elites. Second, a quantitative empirical study is conducted to test the OLC stages moderating impact on the upper echelons diversity and firm performance of the top companies in the Czech Republic.

A detailed procedure is developed to accurately classify organizations at different lifecycle stages, drawing extensively on existing literature and scales.

Paper findings state that more mature the company becomes, more diversified the senior management is regardless the firm performance. Also, the industry dynamism impact has its own role in the relationship between the organization life cycle and senior management diversity which is expressed by the paper findings as well.

Keywords: Top management team, Diversity, Company performance, Organization life cycle.

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INTRODUCTION

Recently, there is a surge of interest in exploring Top management teams (TMT) and Diversity these topics are referring to successful global companies have multinational top management (Berman, 1997).

Research on multicultural teams, however, suggests that national diversity has positive effects for team effectiveness and performance. Diversity in national origin is associated with diversity in values, cognitions and experiences that generate broader knowledge bases and different

perspectives within the team (Cox, Lobel & McLeod, 1991; McLeod & Lobel, 1992; Watson, Kumar & Michaelsen, 1993).

One of the most important factors which can substantially increase the efficiency of decision-making of top management teams (TMT) is the characteristics where we measure efficient composition and diversity of TMT.

Business World tries to find this efficiency by incremental (ongoing) improvement of TMT. The literature examines two important factors substantially influencing the composition,

diversity, life cycle phases and company performance.

In the unstable business environment, there is an ongoing debate as to prevent a repeat of the governance failures that triggered these developments. A recent focus of this debate has been the issue of increasing Top Management Team (TMT) and Board Diversity to improve company performance and reduce groupthink and inertia at the top of large and influential companies in particularly critical situations. Proposals to improve TMT and board diversity have ranged from the launch of voluntary measures to direct intervention through the introduction of quotas to ensure a minimum representation of TMT and board members.

The paper links two independent variables (Top Management Team Diversity) and Company Performance and it investigates how these variables interact by applying moderating variable of Organization Life Cycle, which is vital for each organization especially in a world of fast changes and turbulent environment. Therefore, the research paper sheds a light on the interconnection between TMT and company performance. The results of this study have twofold results- conceptual and practical as it help us to better understand what stays behind diversity in TMTs and how important is the stage of company development in relation to company performance.

LITERATURE REVIEW

Top Management Team and Company Performance

The roots of the Top Management Teams (TMT) perspective lie in the behavioral theory of the firm (Cyert & March, 1963), which suggests that managerial choices are not always following rational motives but are to a large extent influenced by the natural limitations of managers as human beings. Behavioral factors such as bounded rationality, multiple and conflicting goals, various aspiration levels etc., are believed to influence strategic choices made by top executives, which in turn determine board composition. In a particular decision-making situation, managerial decisions are influenced by their own values and **cognitive bases as they impact the managers' perception of the situation and the subsequent**

interpretation of possible choices. In a perceptual model of strategic choice under conditions of bounded rationality, Hambrick and Mason (1984) visualize how **manager's characteristics affect** strategic choice in a three-stage process: a limited field of vision, selective perception and interpreting noticed stimuli based on the **manager's "givens"**.

In their seminal work, Hambrick and Mason (1984) suggest that managers' **observable socio-economic characteristics** can be used as proxies for the more complex psychological dimensions of their personalities. The reasoning is based on the organizational socio-economy approach, which criticizes the use of constructs such as attitudes, needs, values, preferences and cognitions, since **such constructs are "difficult to reliably measure and conceptually validate [and] are neither concrete nor unambiguous in their meanings and interpretation"** (Pfeffer, 1983). Instead, socio-economy is regarded as an important causal variable and whereas the existence of process and other intervening variables between socio-economic composition and organizational outcomes is acknowledged, it is not considered necessary to explore these process constructs, as they are mostly mental processes, which are also considered difficult to access and measure reliably (Pfeffer, 1983). The combination of strategic choice and organizational socio-economy perspective leads to the first TMTs model as suggested by Hambrick and Mason (1984).

Diversity of functional backgrounds also contributes to cohesion by endowing team members with similar frames of reference for problem solving (Dearborn & Simon, 1958; Gupta & Govindarajan, 1984). Like average team tenure, a common functional background contributes to the development of common schema among team members and thereby increases cohesion by providing a common premise for decision making.

Due to difficulties of gaining access to and assessing intricate psychological dimensions of top managers and their actual behavior, organizational socio-economy has become the predominant approach in TMTs research (Daily, Dalton & Cannella, 2003; Hambrick & Mason, 1984; Pettigrew, 1992). Numerous empirical studies scrutinize the effects of top management socio-economics on organizational outcomes, such as

strategy and performance. Especially the topic of team diversity has been of particular interest for researchers from a theoretical point of view (Finkelstein & Hambrick, 1996). Measures of distributional properties (dispersion of a group over specified categories) rather than central tendencies, such as mean, median or proportion, are considered crucial for understanding the effects of socio-economy on organizational outcome. The most recent decade of TMT research is characterized by several important, and at the same time distinguishing, themes. When contrasted with earlier upper echelon investigation, recent research did not carry the burden of validating the original Hambrick and Mason model. Rather, it was able to capitalize on a foundation of empirical results linking not only TMT characteristics and firm strategic profiles (e.g., Bantel & Jackson, 1989; Finkelstein & Hambrick, 1990; Smith, Grimm, Gannon & Chen, 1991). Moreover, earlier work had already established that the TMT model was applicable in diverse contexts, including U.S. and international organizations (e.g., Hoffman & Hegarty, 1993; Wiersema & Bird, 1993), as well as different life cycle stages, and business and corporate strategy arenas (Cannella & Hambrick, 1993; Eisenhardt & Schoonhoven, 1990; Hambrick, Cho and Chen, 1996).

Organization Life Cycle and Top Management Team

In one of the most influential organization lifecycle models, Miller and Friesen (1984) contend that organizations tend to move in a linear sequence of five stages: birth, growth, maturity, revival, and decline. Miller and Friesen (1984) suggest that an organization has unique features at each lifecycle stage with regard to the general state of affairs of the organization. This includes features such as size, age, ownership dispersion, influence of stakeholders on decisions, and the diversity and/or hostility of the organization's environment. Whereas at early lifecycle stages top managers focus primarily on managing external dependencies, organizations become increasingly focused on internal issues as they grow and mature (Dodge & Robbins, 1992). Different lifecycle stages also imply different approaches to strategic decision-making, which means that

TMTs will face different personnel requirements based on the organization's lifecycle stage. The characteristics of a successful TMT may for example be different based on the extent to which they pursue innovative, growth-directed strategies or maintenance-oriented strategies. The decision-making style is also likely to become more participative and decentralized as an organization develops (McNamara & Baden-Fuller, 1999), potentially influencing the type and mix of top manager profiles sought by an organization over the course of its lifecycle. As the organization lifecycle may influence TMT characteristics through a variety of organizational mechanisms, the dissertation will adopt a broad approach to the application of pertinent theories. Key theories that may be drawn upon to explain the varying needs for TMT characteristics at different lifecycle stages include, i.a., socio capital theory (Burt, 1992; Coleman, 1988), resource diversity theory (Barney, 1991), and resource dependence theory (Pfeffer & Salancik, 1978).

A one-size-fits-all approach to TMT characteristics may not be ideal for organizations at all stages of organizational evolution. Indeed, it may be counterproductive for organizations to comply with a set of regulations that are incompatible with their evolutionary stage. For example, if a mandatory measure to increase TMT diversity is designed to improve an average outcome in a large sample of predominantly mature firms, such regulations may at the same time hamper the progress of firms that are at other evolutionary stages such as growth or revival.

METHODOLOGY OF THE RESEARCH

Hypotheses

In this part, hypotheses are elaborated regarding the relationship between TMT diversity and performance, and the relevant independent variables, moderate variable are identified and described.

TMT size

Existing studies have presented mixed results on the impact of TMT size on company performance. Some research on the role of the TMT as an organizational resource has demonstrated a positive relationship between TMT size and firm performance such as innovation or financial

performance. For instance, Sanders and Carpenter (1998) concluded that TMT size reflected a team's collective capacity gather and process complex information. They found a positive relationship between TMT size and expansive global strategies.

Hypothesis 1: Bigger TMT Size is negatively related to company performance

TMT Members Gender

A person's gender identity and expression encompasses multiple factors including genetic influences, brain chemistry, learned behaviors, and personal choices. These factors – shaped by culture, custom, socio constraints and beliefs – affect us all. Gender diversity is measured by the proportion of males and females in the top management teams of the companies expressed by the formula:

$DG = N1/N2$, where DG- Gender diversity, N1- number of female members in the TMT and N2- total number of members in the TMT.

The gender diversity is a typical indicator for gender diversity in a company. Most of the companies encompass of very low number of females which makes the coefficient quite low.

Hypothesis 2: Higher number of TMT Members Gender is negatively related to company performance

TMT Members Average Age

Previous research indicates that the average age of TMT members influences the degree to which they are oriented toward risk during strategic decision-making (Hambrick and Mason 1984; Hitt and Tyler 1991). Older managers possess less physical and mental stamina (Child 1974), have greater psychological commitment to the organizational status quo, and see financial and career security as their primary goals (Hambrick and Mason 1984). Therefore, older executives generally tend to engage in less risk-taking (Vroom and Pahl 1971). Numerous studies have pointed out that personal performance of firm members are affected by the organizational atmosphere or culture of orientation toward risk-taking, tolerance for ambiguity, perseverance in the face of

frustration, and a relative unconcern for social approval (Amabile 1996; Feldman 1980; Golann 1963; Stein 1974). Thus, firms with younger TMT members (on average) will be more inclined to pursue risk-taking strategies than firms with more mature TMT members. On the assumption that performance is enhanced in an environment where risk-taking is encouraged and supported (Amabile 1988; Sternberg et al.1997), we suggest the following hypothesis:

Hypothesis 3: Higher amount of Average Age of TMT is negatively related to company performance

TMT Members Nationalities

People from different nationalities have different life experiences. This flavors their interpretation of events. These differences can bring strength to the group if it is valued and integrated into the group dynamics. However, it can take time, intent and the willingness to be open-minded and non-judgmental about the value the differences bring. It definitely takes effort to make nationality diversity a strength. Nationality diversity is measured by the ratio between foreigners in the TMT team and total number of members in the TMT described by the formula below:

$DN = N1/N2$, where DN- Nationality diversity, N1- number of foreigners in the TMT and N2- total number of members in the TMT. This coefficient is important for the top management team diversity because it shows the proportion of local nationals to the foreign nationals. In many IPOs there are more than two nationalities in the TMT which indicates that the companies are multinational.

Hypothesis 4: Higher number of TMT Members Nationalities are negatively related to company performance.

TMT Members Tenure

This coefficient basically indicates the distribution of time period of the top management team member within the team spent in years and it is important for us to see how long on average the top management team members spend with the companies within the TMT. Team Tenure Diversity is measured by the following formula below:

$DTT = N1/N2$, where DTT- Team tenure diversity, N1-number of TMT members with team tenure less than 5 years and N2- total number of members in the TMT

Hypothesis 5: Higher number of TMT Members Tenure is positively related to company performance.

TMT Members Company Tenure

The company tenure diversity factor is very important for the company as well because it indicates how much the TMT members are devoted to the firm and how long they have been working for the company. In some cases TMT members have been working all their life for one company which shows loyalty, dedication and strong cooperation towards the employer.

We measure this coefficient by the following formula:

$DCT = N1/N2$, where DCT- company tenure diversity, N1-number of TMT members with company tenure less than 10 years and N2- total number of members in the TMT

Hypothesis 6: Higher number of TMT Members Company Tenure is positively related to company performance.

TMT Members Dominant Functions

TMT members dominant function expresses their expertise and experience in certain business areas. Therefore, when company hires new TMT members is crucial to look in their dominant function in order to perform more in the TMT team.

The coefficient of dominant function diversity is measured by the formula:

$DDF = N1/N2$, where DDF- dominant function diversity, N1-number of TMT members with dominant function in non-management field and N2- total number of members in the TMT.

Hypothesis 7: Higher number of TMT Members Dominant Function is not positively related to company performance.

TMT Members Career Length

This TMT characteristic is measured by the ratio between TMT members with career length less than 15 years and TMT members with career length more than 15 years. It is vital for each company that its TMT members possess long experience and exposure to their competent business areas in order to perform well their jobs. The formula below indicates the career length diversity:

$DCL = N1/N2$, where DCL- career length diversity, N1-number of TMT members with length less than 15 years and N2- total number of members in the TMT.

Hypothesis 8: Higher number of TMT Members Career Length is positively related to company performance

TMT Members Education Background

Each TMT member has certain education background but not always it matches their dominant function. Therefore, we measure the ratio between TMT members with non-management education background and the TMT members with education background in management expressed by the formula below:

$D_{EB} = N1/N2$, where D_{EB} - education background diversity, N1-number of TMT members with non-management education background and N2- total number of members in the TMT

Hypothesis 9: Higher number of TMT Members Education Background is not positively related to company performance.

Company Performance

In the literature Company Performance is measured mainly as a ration between Volume of Sales per one employee or ROA per one employee. For the purpose of this paper we have taken the first aforementioned option due to the fact that in the secondary data it was more accessible to collect Volume of Sales and number of employees of the selected companies.

Hypothesis 10: Higher TMT Diversity is positively related to company performance.

TMT Diversity and OLC

In addition to fitting the different characteristics in each stage of organizational life cycle, Miller & Friesen (1984) verify that the sequence of stages does not exactly follow the models found in the literature. There is no sequence that is irreversible, unique and definitive. Hence, the progression stages of life cycle would not be deterministic. The major trend observed is that the organization remains at the same stage. Moreover, the duration of each stage varies considerably. With the growth of each organization, the diversity of their TMT is increasing due to changes in organizational structure, formalization of TMT positions and increasing management operations.

Hypothesis 11: Higher TMT Diversity is positively related to OLC.

Empirical Data Set

The sample of companies comprises of the **largest 60 companies (around 200 TMT Members' profiles)** in the Czech Republic at year-end 2015 according to number of employees and turnover. The independent variable in the paper is the TMT Diversity represented by gender, nationality, team tenure, educational background, age, company tenure. The moderator variable is Organization Life cycle (Birth, Growth, Maturity, Revival/Decline) and the dependent variable is the Company Performance. In the paper is employed correlation analysis by using SPSS software, which enables carrying out of different regression and correlation analysis among different independent variables in order to show to what extent there are interlinks between the independent variable and the dependent variables.

There are two levels from statistical stand point in the research study which are industry level and company level. Each company of the data set is designated with SIC code and the secondary data is gathered from the Thomson Reuters 1 database, annual reports of the selected companies and the website of Czech Trade. The companies are grouped according to the industry code (SIC code). For the purpose of the paper it is considered as an independent variable TMT Diversity, dependent variable Company Performance and moderating variable Organisation Life Cycle Stage. All variables

in the paper are depicted in Table 1 below as follows:

DISCUSSIONS AND FINDINGS

As mentioned in the literature review OLC phases have direct impact on the TMT diversity in all of the researched companies regardless the industry in which the companies are nested. Very little was found in the literature on the question of to what extent the OLC stages impact TMT characteristics but statistically we have proved that there is influence in each phase of the OLC.

The results of the paper indicate that OLC phase of Maturity has significant impact on the TMT Diversity. In the paper comparing management elites in the Czech Republic showed that the mean degree of TMT Diversity is noticeable and important for practitioners and academicians to understand the OLC and Company Performance impact on TMT Diversity.

This finding corroborates the ideas of Miller and Friesen (1984), who suggested that each individual phase of OLC has certain impact on the organization and its top management in terms of decision-making, structure, performance and turnover. The results of the research paper now will be compared to the findings of Miller & Friesen (1984). These results match the literature review on OLC, TMT and Company Performance which is verified through the hypotheses in the paper. It is therefore likely that such connections exist among OLC, TMT and Firm Performance and these findings have important implications for developing investigating all the aspects of OLC impact on TMT Characteristics. Thus, this is an important issue for future research in the area of OLC and TMT Diversity.

Table 2 illustrates the situation for the Central-European country-the Czech Republic, where the TMT members are relatively young in comparison to their counterparts in other Central European countries. We can state based on the table 2 that quite many TMT members possess Master Degree with dominant function in Management due to the fact that in the Czech Republic is highly appreciate it e.g. MBA degree in regard to the TMT characteristics. On other side, in the biggest Czech companies we observe not so diversified TMTs in respect to age, nationality, gender and career length diversity. Statistically, the ratio of female

TMT members and foreigner to the total number of TMT is much lower than in neighbouring countries from the region. Furthermore, statistical results show positive relationship between TMT Diversity and Company Performance expressed in Table 3, which is related to the fact that highly diversified TMTs increase level of creativity, innovations, internationalization and firm performance.

Moderation effects are tested with multiple regression analysis, where all predictor variables and their interaction term are centered prior to model estimation to improve interpretation of regression coefficients. A single regression equation forms the basic moderation model:

$Y = \beta_0 + \beta_1 X + \beta_2 Z + \beta_3 XZ + e$, where β_1 is the coefficient relating the independent variable, TMT Diversity, to the outcome, Company Performance, when $Z = 0$, β_2 is the coefficient relating the moderator variable-OLC Stages, Z , to the outcome when TMT Diversity = 0, β_0 is the intercept in the equation, and e is the residual in the equation.

The regression coefficient for the interaction term, β_3 , provides an estimate of the moderation effect. If β_3 is statistically different from zero, there is significant moderation of the TMT Diversity-Company Performance relation in the data. Plotting interaction effects aids in the interpretation of moderation to show how the slope of Company Performance on TMT Diversity is dependent on the value of the moderator variable-OLC.

CONCLUSIONS

The statistical findings of this study demonstrated that TMT diversity has an important influence on firm performance. These results propose some conceptual and practical implications about the relationship between TMT diversity and company performance. According to the results presented here the disadvantages related to a large TMT outweigh the benefits in terms of fostering management tool diversity. Structural inertia, increased cognitive and emotional conflict among TMT members, longer decision-making time, and decreased opportunities for interaction among members may contribute to this decline. Thus, to promote firm performance, the size of the TMT should be carefully considered. Such firms must develop

mechanisms to increase interaction among TMT members and compositional diversity in order to reduce the risks of high organizational inertia and thus increase performance. The results of our research indicate that higher average age of a TMT has negative effects on company performance. This effect may be attributable to organisational structure rigidity, risk aversion, adherence to the status quo, and pursuit of financial and career security among older TMT members. Therefore, a firm must include younger executives on the TMT in order to increase organizational performance. In addition to TMT size and average age, TMT diversity had a significant effect on firm performance. Ten dimensions of TMT diversity were examined in this study: age, function, and educational background diversity. Only TMT functional diversity had a significant and positive effect on organizational performance. Our results indicate that hiring TMT members with diverse functional experience enhances performance by enabling a firm to exploit a variety of knowledge sources and different viewpoints.

In conclusion, the findings of this study suggested that TMT diversity must be considered for firms that desire to foster firm performance. In this paper, the relationship between TMT characteristics and firm performance was elucidated. Many previous studies have shown that TMT characteristics have critical effects on organizational outcomes and contextual factors such as firm culture, climate, and knowledge base. In addition, many scholars have studied the social and contextual factors that influence company performance. However, few studies have examined the direct relationship between TMT diversity and organizational performance through the prism of OLC, as most of existing studies are concerned with a group impact on firm performance. A few papers that examined the relationship between TMT diversity and organizational performance did not **successfully address top managers' various characteristics other than their business-related abilities or backgrounds.**

In this study, TMT characteristics are viewed as antecedents of organizational features that influence organizational performance. Future research may identify other organizational or environmental factors that enhance or undermine firm efficiency. For example, firms' **strategy types** can impact firm performance. Firms that focus on

technological innovation and make large investments in R&D activities are expected to have higher efficiency and performance. As aforementioned, industry effects also may exist.

In addition, moderating factor between TMT diversity and firm performance is nested in organization life cycle stage. For instance, organizational structure or the learning process may also affect the relationship between TMT diversity and organizational performance. Organization life cycle stages may themselves play a role in mediating or moderating the effect of TMT diversity on firm performance. In terms of research methodology, increasing the number of sample firms for the Czech Republic will certainly enhance applicability and reliability of the paper. With a larger sample, we can conduct multilevel analysis of measurement items to understand better the influence of industry dynamism on TMT diversity and company performance. Sub-samplings from a sizable data set also provide researchers opportunities to broaden the scope of studies on TMT diversity by testing diverse hypotheses empirically. Future research may address issues above with a larger data set, shedding more light on TMT diversity and OLC phases and their importance in the business world.

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Attachment 1:

Table 1: Descriptions of variables

Variable	Description
(Dependent) Company Performance	Measured by volume of Sales per employee
(Independent) TMT Size	Total Number of TMT members
(Independent) TMT Members average age	Average age of all TMT members
(Independent) TMT Members Gender	Variation of the Blau index: $H = \frac{1}{S} \sum_{i=1}^3 S_i^2$, where H is the heterogeneity measure and S the percentage of TMT members in each of three gender categories
(Independent) TMT Members Nationality	Variation of the Blau index: $H = \frac{1}{S} \sum_{i=1}^2 S_i^2$, where H is the heterogeneity measure and S the percentage of TMT members from two categories- Czech and Non-Czech Nationals
(Independent) TMT Members Tenure	Length of time period of member in the TMT
(Independent) TMT Member Career Length	Career Length of time period of member
(Independent) TMT Member Educational Background	$H = \frac{1}{S} \sum_{i=1}^2 S_i^2$, where - education background diversity, N1-number of TMT members with non-management education background and N2- total number of members in the TMT
(Independent) Dominant Function diversity in TMT	Variation of the Blau index: $H = \frac{1}{S} \sum_{i=1}^{10} S_i^2$, where H is the heterogeneity measure and S the percentage of TMT members in each of ten special dominant functions
(Moderator) Organisation Life Cycle Phases	The OLC phases are valued 1 to 5, whereas 1 is Birth and 5 is decline

Attachment 2:

Table 2: Descriptive Statistics

	Mean	Std. Deviation	N
TMT Size	4,35	,000	187
Average Age	1952,9 5	7,286	187
Gender	,87	,341	187
Nationality	,00	,000	187
TMT Tenure	4,26	3,498	187
Company Tenure	7,17	7,026	187
Education Background	21,91	12,797	187
Career Length	,10	,303	187
Dominant Function	32,28	6,867	187
Company Performance	2,41	1,224	187

Notes: Means and standard deviations are reported for the unweighted sample