The Imperative for Gender Diversity on Boards

By Doreen Lilienfeld and Nell Beekman

In recent years, several studies have shown what some might intuitively know: having women on the board of directors is beneficial to corporations. But despite mounting evidence in favor of women in the boardroom, women continue to hold only a small percentage of corporate board seats in the United States, and their numbers have not increased significantly over the past several years.[1] As public awareness of this issue increases, companies whose boards lack diversity may be subject to scrutiny and negative publicity.[2]

Although negative media coverage and public pressure have induced certain companies to add women to their boards, so far the threat of bad publicity has not caused widespread change. Women hold 11 percent of board seats at the largest companies worldwide. In 2013, among the 100 largest US public companies listed on the New York Stock Exchange (NYSE) or NASDAQ, women held approximately 21 percent of board seats, and only two companies had boards composed of at least 40 percent women.[3] Female directors tend to be more common in larger companies, so while 16.9 percent of directors in the S&P 500 are women, the percentage is 13.5 percent in the S&P Midcaps and only 11.3 percent in the S&P Smallcaps.[4] However, their representation on corporate boards has been increasing very slowly: the percentage of female directors at Fortune 100 companies increased from 16.9 percent to 19.7 percent from 2004 to 2012.[5]

There is some disagreement about why progress in addressing gender imbalance has been so slow. Women tend to attribute the lack of female directors to board members' inclination to choose new directors from their existing networks and to favor candidates who look like them; men often cite the difficulty of identifying qualified female candidates.[6] Boards' preferences for director candidates with CEO experience, thereby excluding many otherwise qualified women, have also been blamed for the low number of female directors.[7] In addition, increasing the number of female directors often involves replacing older, more experienced men with younger and less experienced women, although this transition may be facilitated by the prevalence of mandatory retirement ages for directors at many companies and the large percentage of directors who are near or above the typical retirement age.[8]

Whatever the underlying cause, the reluctance of boards to add more female directors may actually be harmful to companies, as a growing body of research demonstrates positive correlations between gender diversity on boards and improvements in corporate governance and financial performance. The Credit Suisse Research Institute conducted one of the largest studies, which included data from 2,360 companies worldwide from 2006 to 2012, and found that companies with a market capitalization of more than $10 billion that have at least one female director outperformed peer companies with all-male boards by 26 percent.[9] The Credit Suisse study also found that companies with mixed-gender boards averaged higher net income growth, lower net debt-to-equity ratio, and faster reduction in debt compared to companies with all-male boards.

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Three Recent Studies

In the past year alone, three studies have demonstrated the benefits of women serving in leadership roles. A study by Thomson Reuters found that companies with all-male boards underperformed and displayed slightly more volatility compared to companies with mixed boards.[10] A study from the University of British Columbia's School of Business published in the *Journal of Corporate Finance* concluded that companies pay less for acquisitions when they have more women sitting on their boards, indicating that women are less inclined to chase risky deals and tend to demand more for the company's money.[11] Finally, a report published by the professional services firm Rothstein Kass compared an index of hedge funds run by women with a broader hedge fund index and found the women-run hedge funds had a higher average return.[12]

Given the research, it would be reasonable to expect companies to rapidly and voluntarily increase the number of women in the boardroom without any outside pressure, but, as discussed above, this has not yet happened. In response, there has been an effort, both in the United States and globally, to increase gender diversity on corporate boards through government action, advocacy, and shareholder pressure. The US has tended to favor government action that encourages board diversity rather than mandating specific quotas. One example is Senate Concurrent Resolution (SCR) 62, which was passed by the California State Senate in August 2013 by a 30-6 vote. SCR 62 urges, but does not require, publicly traded corporations in California with fewer than five board seats to have at least one female director, those with five to eight board seats to have at least two female directors, and those with nine or more director seats to have at least three female directors. The SEC encourages diversity by requiring public companies to disclose in their annual proxies whether and how board or nominating committees take diversity into account in identifying board nominees.

Much of the drive to get more women on boards has come from outside government, as industry and nonprofit organizations and programs have been formed to advocate for greater gender diversity. Some groups work toward this goal by attempting to influence companies directly. For example, the Thirty Percent Coalition, an organization composed of senior business executives, national women's organizations, institutional investors, corporate governance experts, and board members, sends letters to large public companies with no female board members and files shareholder resolutions asking them to commit to greater gender diversity on their boards. Other groups, such as 2020 Women on Boards, campaign to increase public awareness of the importance of gender diversity. There are also initiatives and programs that focus on preparing women to take positions on corporate boards. On the Board, a fellowship program run by George Washington University School of Business, selects a small number of female executives with the goal of placing them on corporate boards and provides them with mentoring and training in topics such as finance and cybersecurity.[13]

Pressure from Shareholders

Companies have also been facing pressure from shareholders to diversify their boards. Apple Inc., recently added language to its board committee charter promising to consider women and minorities as board candidates after shareholders Trillium Asset Management LLC and the Sustainability Group registered their displeasure that Apple has only one woman on its board and threatened to bring the issue to a vote.[14] In addition to putting pressure on companies, shareholders sometimes petition the government to adopt more stringent rules. In Canada, the Ontario Securities Commission is proposing to adopt a "comply or explain" rule, which would require companies to disclose, among other things, the number and proportion of female directors and executives, voluntarily adopted targets (if any) for the number of female directors and executives, and progress toward meeting those targets.[15] The Ontario Teachers' Pension Plan, citing evidence that more diverse boards make better decisions, urged the Ontario Securities Commission to go even further and adopt a rule requiring any company with fewer than three female directors by 2020 to be delisted from the Toronto Stock Exchange.[16]

When companies fail to voluntarily increase the number of women holding board seats, governments may decide to intervene. Over the past decade, several countries have passed quota laws requiring a minimum percentage of women on public company boards. In 2003, Norway was the first country to pass a quota law, mandating that public companies achieve 40 percent representation of women on their boards within five years; Belgium, France, Italy, the Netherlands, and Spain have since passed similar laws. Although the United Kingdom has so far declined to introduce quotas, the business secretary warned that quotas were a "real possibility" after the increase in the proportion of female directors stalled.[17] In November 2013, the European Parliament voted in favor of a proposed law that would require large, publicly listed companies to have at least 40 percent women among nonexecutive directors by the year 2020, although the directive will still require the backing of European Union member states to become law.[18] Germany's new coalition government announced its plans to require German-listed companies to fill 30 percent of their supervisory board seats with women starting in 2016, four years earlier than originally planned.[19] Although quota laws were first introduced in Europe and are still most common there, other countries, such as Malaysia and Kenya, have also adopted quota laws. In most cases, the stated justification for imposing quotas is that companies failed to increase the number of female directors when left to their own devices.

Although the countries that impose and effectively enforce quotas have generally been successful at increasing gender diversity on boards,[20] these laws remain controversial, even in Europe. Quotas are likely not the ideal way to achieve gender diversity, even when they work: at least one study has indicated that the Norwegian statute had a negative impact on stock prices, operating performance, and the experience level of directors.[21]

Ideally, companies would not need to be compelled, or even pressured, to address gender imbalance in the boardroom. In light of the research indicating that more diverse boards are correlated with better performance and decisionmaking, it is becoming increasingly clear that companies with all-male boards are failing to take advantage of the value added by diversity. Companies that fail to diversify their boards may also be subject to embarrassing public criticism and shareholder pressure. In addition, if boards do not voluntarily address their lack of diversity, public frustration may make the political landscape more receptive to heavy-handed government intervention, as demonstrated by the quota laws introduced over the past decade. As the evidence in favor of gender diversity mounts, it is time for companies to stop hesitating and take action. As one male CEO said recently, "This issue is not about equity or fairness, it's about winning."[22]

Notes

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3. Shearman & Sterling LLP, "11th Annual Survey of the Largest U.S. Public Companies," Corporate Governance Book 2, 13 (2013).

4. Kimberly Gladman & Michelle Lamb, GMI Ratings', 2013 Women on Boards Survey 17 (2013), *http://info.gmiratings.com/Portals/30022/docs/gmiratings_wob_042013.pdf*.

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8. Of the 100 largest US public companies listed on NYSE or NASDAQ, 81 percent have a mandatory retirement age for directors. Shearman & Sterling, *supra* n.4, at 2, 21. Twenty percent of board seats are held by directors who are near or above age 72, which is the most common mandatory retirement age among companies that have a mandatory retirement age for directors. Ernst & Young, Diversity Drives Diversity 1, 12 (2013), *http://www.ey.com/Publication/vwLUAssets/EY-Diversity-drives-diversity/$FILE/EY-Diversity-drives-diversity.pdf.*

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10. André Chanavat & Katharine Ramsden, Thomson Reuters, Mining the Metrics of Board Diversity 5 (2013), *http://share.thomsonreuters.com/pr_us/gender_diversity_whitepaper.pdf.*

11. Jena McGregor, "More Women on Boards, Cheaper Mergers," Wash. Post, Nov. 27, 2013, *http://www.washingtonpost.com/blogs/on-leadership/wp/2013/1½7/more-women-on-boards-cheaper-mergers/*.

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13. Elizabeth Olsen, "Focused Effort to Narrow the Gender Gap on Corporate Boards," N.Y. Times, Oct. 24, 2013, *http://dealbook.nytimes.com/2013/10/24/focused-effort-to-narrow-the-gender-gap-on-corporate-boards/*.

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16. Janet McFarland, "Ontario Teachers' Pension Plan Wants OSC to Force Firms to Add Female Directors," The Globe and Mail, Oct. 7, 2013, *http://www.theglobeandmail.com/report-on-business/companies-should-have-3-women-directors-or-face-delisting-teachers/article14721742/*.

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18. Under the proposed law, companies that do not achieve the 40 percent threshold would be required to give priority to female candidates in cases in which the male and female candidates are equally qualified, and may face other sanctions that will be determined by each individual EU member state. With respect to executive directors, the proposed law includes a "flexi quota" requiring companies to set self-regulated targets for gender balance and provide annual reports on the progress made. Press Release, European Commission, "Cracking Europe's Glass Ceiling: European Parliament Backs Commission's Women on Boards Proposal" (Nov. 20, 2013), *http://europa.eu/rapid/press-release_IP-13-1118_en.htm*.

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20. *See supra* n.4.

21. Kenneth R. Ahearn & Amy K. Dittmar, "The Changing of the Boards: The Impact on Firm Valuation of Mandated Female Board Representation," Quarterly J. of Econ. August 3, 2012, at 137, available at *http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1364470*.

22. Catalyst, *supra* n.2 (quoting Thomas Falk, Chairman and CEO of Kimberly-Clark Corporation).