Mandating boardroom diversity can narrow the opportunity gap for women

By Brian Bolton

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Kudos to California, where the state governor, Jerry Brown, recently signed into law new requirements for companies headquartered in the state to include more women on their boards. The law will force heavyweights such as Apple, Facebook, Tesla, and Google (Alphabet) to revamp their boards to comply.

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Supporters believe increasing board diversity is important for both social and economic reasons; that a more diverse pool of directors creates a better board, with different and more innovative perspectives. Opponents of the law question its efficacy, saying it's like treating a symptom rather than the disease. But because it's human behaviour that we're trying to change in this case, treating the symptom can be a big first step towards treating the disease.

Specifically, all companies in California will be required to have at least one woman on their board by 2019. Boards with five or fewer directors will need two female directors by 2021 and larger boards will need three. Non-compliant firms would be subject to (relatively small) fines.

To assess the scope of the change, let's review the statistics on diversity in the upper ranks of corporations. In 2017, for the 1,500 largest US companies (all board statistics are my own, using data from advisory firm ISS):

- 5% of firms have a female CEO.
- 4% of firms have a female board chair.
- 16% of directors are women.
- 15% of audit and compensation committees have a female chair.
- Female directors own 75% the amount of stock that male directors own; this is independent of their tenure on the board.
- 7% of boards have at least three women and 2% have at least four women; all 1,500 boards have at least three men.
- Women account for 57% of all college degrees and 47% of all business degrees in the US.

Exercising influence

With such gender imbalances, most experts agree that board diversity needs to change. But mandating quotas doesn't convince everyone.

One concern comes from an efficient markets perspective. This argument suggests that if having more women on boards were best for business, greedy value-maximising companies would already be doing it. This is precisely the business case for boardrooms being 84% male. This business case assumes that the market for corporate directors is efficient – but it is anything but. It's a cartel controlled by middle-aged white men who are loathe to give up their privileges.

Stanford law professor, Joseph Grundfest, makes a different market-based argument that has more relevance. He suggests that the most effective way to bring change to the boardroom is for large, institutional investors – like the California Public Employees Retirement System (CalPERS) – to exercise their capital markets influence and refuse to invest in companies that do not meet certain diversity, equity or other standards. Non-compliant firms will see their stock prices fall and executives and directors will earn less money. This can work; hurting executives and directors in their bank accounts certainly should make them listen. And it can be done in addition to regulators mandating certain standards.

This approach, however, may have limited impact. Even the largest institutional investors aren't always able to effect corporate behaviour. In June 2018, BlackRock Inc, one of the world's largest institutional investors, supported a proposal to formally separate the roles of CEO and board chair at Tesla, to make shareholders less dependent on one single individual. The company opposed the idea, and, despite BlackRock's 6% ownership stake, the proposal was defeated, 84% to 16%. Three months later, after a pattern of unpredictable and irresponsible behaviour by CEO and chair Elon Musk, the Securities & Exchange Commission intervened, requiring the company to separate the positions. Left to their own devices, companies don't always know best.

Admittedly, California's new law is imperfect. It will likely have some short-term negative consequences – including legal battles, firm relocations, and female directors being seen as token hires.

Another issue concerns how companies define "diversity". Recent research suggested that when companies do expand their definition of "diversity" beyond gender or ethnicity, they end up appointing directors with different experiences and perspectives – but at the expense of women and minorities. That is, boards do not increase the number of diverse directors on the board, but rather increase the types of diversity on the board. A board may go from having one female and two non-white directors, for example, to having two female and one non-white director. So firms may appoint more women but at the expense of having fewer other underrepresented minorities or vice versa.

Narrowing the opportunity gap

To best appreciate the benefits associated with governments mandating gender boardroom diversity, we must focus on the long-term.

Harvard economics professor, Claudia Goldin, is arguably the world's foremost authority on the gender income gap. Her research highlights two important points. Yes, women earn 78 cents for every dollar that men earn. However, this is because women are not doing the same work and working the same hours as men. Some of the difference is due to the jobs people choose; most of the difference is due to how jobs are compensated. She concludes that the income disparity is not due to wage discrimination but because the labour markets incentivise men and women differently. That is, the income gap exists because there's an opportunity gap.

If wage discrimination is not the problem, then we need to stop focusing on the 78 cents ratio. This gap is too easy for companies to address: they can hire a woman and a man, with similar credentials, for similar jobs, and pay them the same when they start. Problem solved. But doing so does little to address who is more likely to get promoted, who is more likely to end up in the C-suite or who is more likely to end up in the boardroom. When companies, the media, and politicians focus on the 78 cents number, they are focused on the symptom rather than the cause – and it is easy for companies to address while they continue to ignore the cause.

Oxford finance professor, Renée Adams, has also written, on this site and elsewhere, that in order to reach the boardroom, women need to stay in the workforce. She is not a fan of quotas, in general, but would rather see regulators focus on other structural initiatives that encourage women to stay in the workforce.

California's new law is just such a structural initiative. The same is true about national quotas for gender diversity in Norway, France, Italy and many other countries. Changing histories of economic, cultural and social traditions is a long-term investment. And men and women have always responded to how markets incentivise them. Mandating quotas for gender diversity changes the labour market incentives for both men and women.

When women see that they have greater opportunity to join a board, they are more likely to pursue executive positions. When women see that they are more likely to be successful in executive positions, they are more likely to stay in the workforce longer or to return to the workforce after having children. And when women see that their career potential is unlimited, they are more likely to pursue college majors and initial jobs that will tap into that unlimited potential. California's new law requiring boardroom diversity won't solve all gender equity issues in the short-term, but it can go a long way to narrowing the opportunity gap over the long-term.

In the interest of full disclosure, I am a middle-aged white male. I have never questioned my opportunities. Business and society would be better off if nobody else had to question their opportunities, either.

ABOUT THE AUTHOR

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