DIVERSE BOARDS

RESEARCH SPOTLIGHT

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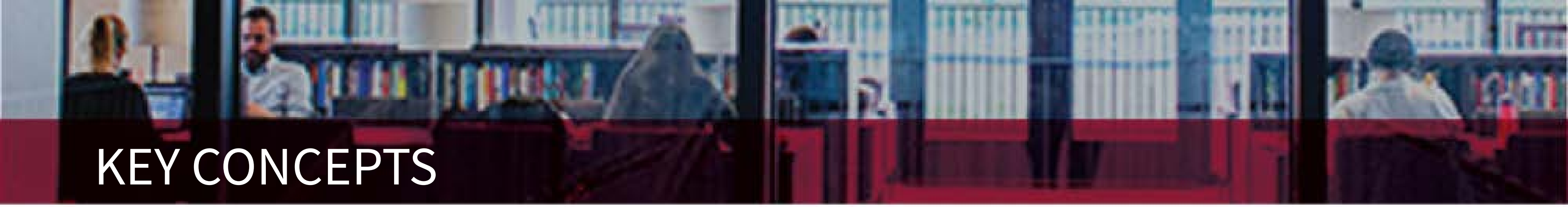


KEY CONCEPTS

Diverse boards are those whose members are heterogeneous in terms of background, race, gender, etc.

- Potential benefits:
  - (+) Improve decision making by ensuring board has full array of knowledge.
  - (+) Overcome tendencies toward "groupthink" and premature consensus.
  - (+) Important social value, consistent with equality.

- Potential costs:
  - (-) Can decrease effectiveness: less information sharing, cohesiveness, cooperation.
  - (-) Can harm performance if quotas are valued more highly than experience.

Research evidence on board diversity and corporate outcomes is highly mixed.

DIVERSITY AND PERFORMANCE

- Erhardt, Werbel, and Shrader (2003) examine the relationship between diverse boards and firm performance.
- Sample: 112 companies in the Fortune 1000, 1993 and 1998.
- Measure operating performance (ROA and ROI) at five-year intervals to determine whether an increase in board diversity (gender and ethnicity) is associated with an improvement in operating results.
- Find positive association between diversity and performance.

Conclusion: diverse boards improve corporate performance.

DIVERSITY AND PERFORMANCE

- Carter, D'Souza, Simkins, and Simpson (2010) also examine the relationship between diverse boards and firm performance.

- Sample: 641 companies in the S&P 500, 1998-2002.
  - Gender and ethnic diversity tested separately.
  - Board and committees (audit, compensation, nominating) tested separately.

- Results are mixed:
  - Full board diversity: Positively associated with ROA (gender and ethnicity)
  - Committee diversity: Positively associated with ROA (gender only)
  - No associations for either with Tobin's Q (gender or ethnicity)

Conclusion: diverse boards and committees have modest impact on performance.

DIVERSITY AND PERFORMANCE

- Wang and Clift (2009) examine the relationship between diverse boards and firm performance in an international setting.
- Sample: 243 large Australian companies, 2003-2006.
  - Gender and ethnic diversity tested separately.
- Measure the relationship between boardroom diversity and subsequent operating performance (ROA, ROE, and total shareholder returns).
- Find no association between gender diversity and performance.
- Find no association between ethnic diversity and performance.

Conclusion: diversity has no impact on corporate performance.

DIVERSITY AND PERFORMANCE

- Gregory-Smith, Main, and O’Reilly (2014) examine the relationship between gender diversity and firm performance.

- Sample: 350 large U.K. companies, 1996-2011.

- Measure the relationship between female board representation and operating performance (ROA, ROE, market-to-book value, and total shareholder returns).

- Find no association between gender diversity and performance.

Conclusion: diversity has no impact on corporate performance.

DIVERSITY AND PERFORMANCE

- Zahra and Stanton (1988) study the relationship between diversity and firm performance.
- Sample: 100 companies in Fortune 500, 1980.
  - Gender and ethnic diversity tested in combination.
- Performance measured in terms of ROE and earnings-per-share growth.
- Find a negative association between diversity and performance.

Conclusion: diversity might have a negative impact on performance.

DIVERSITY AND GOVERNANCE QUALITY

- Westphal and Zajac (1995) examine the relationship between diversity and CEO compensation.
- Sample: 413 companies in Fortune 500, 1986-1991.
  - Diversity measured as "social similarity" between the CEO and full board.
  - Attributes include functional background, education, age, insider/outsider status.
- Hypothesize that social similarity leads to more favorable (less critical) performance evaluations and therefore higher pay.
- Find that social similarity is correlated with higher compensation.

Conclusion: diverse boards provide more independent monitoring.

DIVERSITY AND GOVERNANCE QUALITY

- Belliveau, O'Reilly, and Wade (1996) examine the associations between diversity, social status, and compensation.
- Sample: 61 large companies, 1984-1985.
  - Compare CEO and comp committee chair on two dimensions.
  - Social similarity: career history and educational background.
  - Social status: boards, clubs, and prestige of educational institution.
- Find no correlation between social similarity and compensation.
- Find positive correlation between social status and compensation: CEOs that are higher status than comp committee chair receive 16% higher pay.

Conclusion: diversity does not improve independence, power does.

DIVERSITY AND GOVERNANCE QUALITY

- Adams and Ferreira (2009) study the impact of gender diversity on governance quality across multiple variables.
- Sample: 1,939 companies and 86,714 directorships, 1996-2003.
- Find that:
  - Females have better attendance records than males.
  - Males have better attendance records when females serve on the board.
  - Boards with females are more likely to fire underperforming CEO.
  - They also include more equity-based compensation in CEO pay packages.
  - No association between gender diversity and performance (Tobin's Q or ROA).

Conclusion: gender diversity contributes to governance quality but not performance.

DIVERSITY AND GOVERNANCE QUALITY

- Ahern and Dittmar (2012) study the impact of gender quotas on governance quality and performance.
- Sample: 248 companies in Norway, 2001-2009.
  - 2003 law required 40% of Norwegian directors to be female (up from 9% prior).
- Find that:
  - Board composition changed dramatically in terms of gender representation and also age, education, and experience.
  - New female directors were younger and less experienced.
  - Quota associated with significant decreases in firm value (Tobin's Q).

Conclusion: diversity quotas harm governance quality and firm value.

DIVERSITY AND GOVERNANCE QUALITY

- Rhode and Packel (2014) provide a literature review of the relationship between diversity and corporate governance outcomes.
- Sample: 20+ studies on boardroom diversity, 1980s-2010s.
- Find highly mixed results (positive, negative, and neutral) across studies.

Conclusion: diversity has an uncertain impact on governance quality.

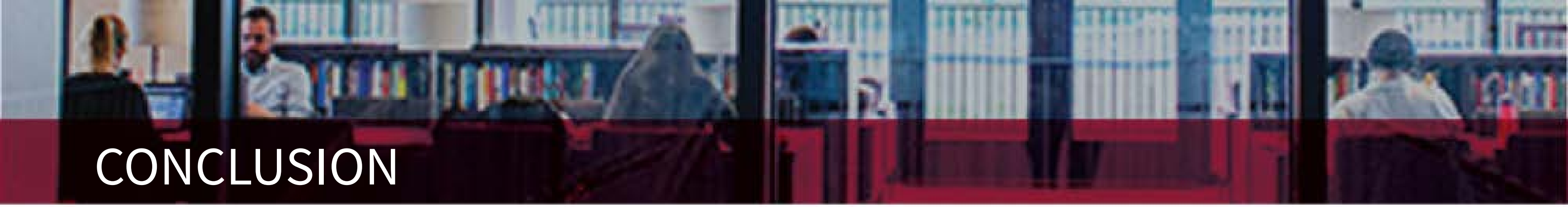
> "The empirical research on the effect of board diversity on firm performance is inconclusive, and the results are highly dependent on methodology. The mixed results reflect the different time periods, countries, economic environments, types of companies, and measures of diversity and financial performance."

DIVERSITY AND GROUP PERFORMANCE

- Williams and O'Reilly (1998) review the research literature on the relationship between diversity and group performance.
- Sample: 80+ studies on group diversity, 1960s-1990s.
  - Grouped by five measures of diversity: background, tenure, age, gender, race.
- Find that diversity is generally associated with less effective group functioning, higher turnover, and dissatisfaction.

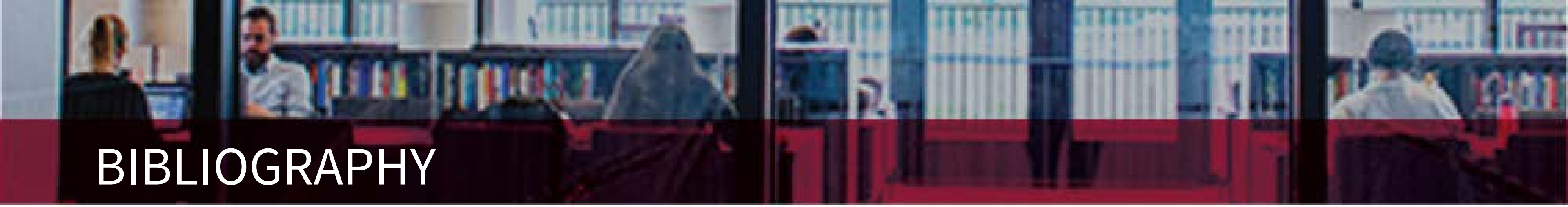
Conclusion: diversity needs to be well managed in order to be effective.

> "Increased diversity typically has negative effects on the ability of the group to meet its members' needs and to function effectively over time. … The challenge is to develop ways to accommodate these tendencies so that their negative effects are attenuated and the positive benefits of diversity can be realized."



CONCLUSION

- The relationship between boardroom diversity and corporate performance is not conclusive.
- Research evidence is highly mixed. Studies have found positive, neutral, and negative effects.
- “Diversity for the sake of diversity” tends to harm governance quality, primarily when it leads to forced turnover and the appointment of less experienced directors.
- Efforts to increase boardroom diversity are best addressed through concerted efforts to recruit qualified professionals rather than quotas.



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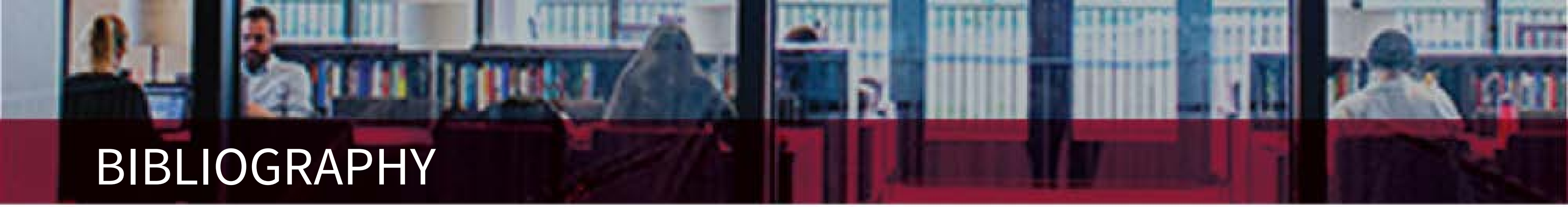

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