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## QUOTA REGULATIONS OF GENDER COMPOSITION ON BOARDS OF DIRECTORS

NINA SMITH<sup>1</sup>

### Introduction

During the last ten years, a number of European countries have implemented more or less radical regulations on the gender composition of the largest companies' supervisory boards. Norway was the first country to implement a binding quota of 40 percent by law in 2005 that took full effect in 2008. Recently, Iceland has followed Norway's suit and now has a binding 40 percent quota. In 2012, the European Commission announced a proposal for a directive related to gender representation on boards with binding quotas of 40 percent for all EU companies (European Commission 2012). Although the proposal was not approved by the European Commission, the idea of regulating board composition is still high on the agenda in many European countries and in the European Union. In the autumn of 2013, the EU Parliament voted in favour of quotation, and one of the big EU countries that used to be reluctant in this area, Germany, decided to implement a 30 percent binding quota on German DAX companies.

The main reason for these new regulations is broad political pressure on companies to push women further up their internal hierarchies. In many countries over half of all university graduates are women, and they have been full-time members of the labour force for decades. However only about 18 percent of board members in large EU companies were women in 2013 (European Commission 2014a). Female representation in boardrooms has increased only slowly in recent decades, despite the fact that an increasing proportion of women have succeeded in climbing at least a few steps of the career ladder within firms. From an economic point of view this evidence may reflect a loss of talent and

human capital investments, and may cause an efficiency loss for firms. There are, of course, also other political arguments for a larger proportion of women getting onto boards of directors like fairness and equal opportunity, but this article focuses on the economic arguments for and against quotas on the gender composition of supervisory boards.

### Women on boards of directors in the EU and policy regulations

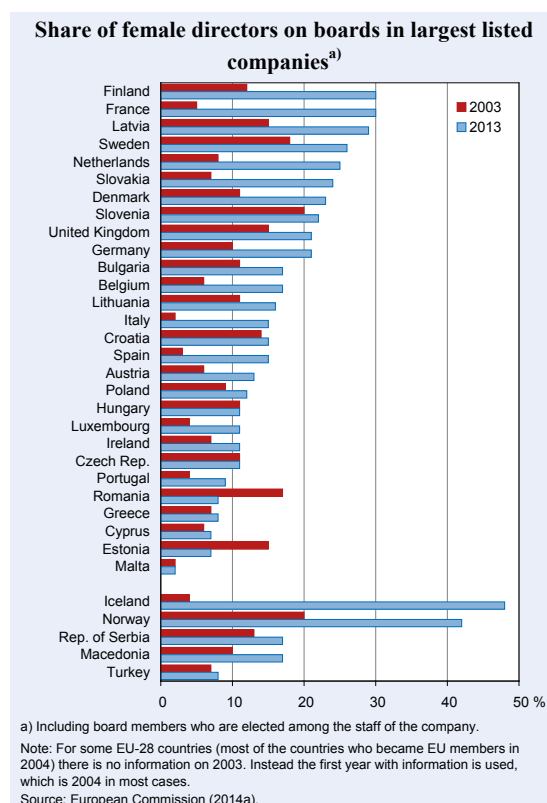
Times seem to be changing. The share of women on boards of directors in the 28 EU countries has been increasing during the latest ten years, and especially since 2010 this increase has been almost 'dramatic'. In 2003, the average share of female board members was nine percent, a figure that increased to 12 percent in 2010 and to 18 percent in 2013 (European Commission 2014a,b).

The average figures mask a large variation across EU countries, both with respect to the level and the speed of change in female board representation. Figure 1 shows the share of female members on the boards of the largest companies in 2003 and October 2013 in the 28 EU countries plus five other European countries that are included in the regular EU database on female board membership.

According to Figure 1, Finland and France are now the two EU forerunner countries with the largest share of female board members (25 percent), while at the other end of the scale, Malta, Estonia, Cyprus, Greece, Romania, and Portugal have less than ten percent of females on the boards of their largest companies. All 28 EU countries are far below the level of 40 percent that the European Commission proposed in 2012. Only the non-EU countries Norway and Iceland have reached this goal. From Figure 1 it is clear that in many countries, mainly Western and Northern European countries, the share of women on the board of directors has increased significantly during the ten year period. In other countries like Romania and Estonia, the share of female directors has stagnated or even decreased considerably.

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Figure 1



The development represented by Figure 1 may partly be the result of the initiatives launched by national governments and the European Commission since 2003 – the causality may, of course, also be reversed! About half of the 28 EU countries have adopted the diversity issue in the official guidelines for Good Corporate Governance (GCG), while eight EU countries have decided or already implemented more or less binding quotas like Norway and Iceland (see Table 1). In Finland, there has to be at least one woman on the board as of 2010, a binding quota of 20 percent is in force as of 2014 and 40 percent in 2017 in France, while Italy and Germany have decided to introduce binding quotas of 33 or 30 percent in 2015 and 2016, respectively. A ‘binding’ quota regulation is defined as a regulation where non-compliance implies more or less severe sanctions on the company.

In the 13 EU countries that have introduced or decided upon quota or soft law regulations on the gender composition of boards, the average female proportion of women in the boards of the largest listed companies increased from eight percent in 2003 to 20 percent in 2013 (non-weighted average of countries). In the comparison group of EU countries that did not introduce any regulation, the increase during the same period was only from nine percent to 11 percent. Thus, it seems fair to argue

that the soft law regulations, quotas, and/or the mere discussion and political signals of potential quotation may have had a major impact on the behaviour of the largest companies in many EU countries, although the speed of change, at least until recently, has been slower than in Iceland and Norway.

Outside Europe times also seem to be changing and the low level of female representation on boards of directors is on the agenda in many countries including the US, Canada, Australia and a number of East Asian countries. Some of these countries have introduced soft law regulations (guidelines for good corporate governance, ‘comply or explain’ rules etc.) see a recent survey on regulations in Deloitte (2013).

### Women on the board of directors: do they make a difference?

The public discussion over the presence of women on the boards of directors of privately-owned companies has been heated in many European countries. The economic arguments in favour of more women often refer to the large number of highly-educated women with university degrees, the increasing number of females who make a career in private sector jobs, and the loss of talent when so few women reach board positions. The most frequent arguments against formal regulations are that regulations and quotation mean that it will not be the best individuals who become board members, or that board composition will be sub-optimal when regulated by outside authorities. If a company is initially optimising its behaviour when selecting board members, a quota will imply a distortion of this behaviour and will potentially reduce efficiency. The key question is whether there are initially market failures, imperfect information or discriminative preferences that govern the selection processes of new board members. If, for instance, an ‘old boys’ network’ is protecting the status quo in terms of positions and power, or if only incomplete and outdated information is available on potential female directors’ qualifications, a quota regulation obliging companies to hire more qualified women might improve the efficiency of their board selection process.

Research in this area lists a number of further arguments in favour of and against more gender balanced board composition (Adams and Ferreira 2009; Ferreira 2010; Terjesen, Sealy and Singh 2009). Diversity on boards is expected to create a qualitatively more valuable decision-making process compared to less diverse

Table 1

| Quota regulations or softer regulations, inclusive gender diversity in official guidelines for good corporate governance (GCG).   |                           |                                  |   |   |
|---|---------------------------|----------------------------------|---|---|
|   | Compliance year for quota | Quota (private-sector companies) | Gender diversity in guide-lines for good corporate governance (GCG) | Increase female share on boards, 2003-2013* |
| EU countries with quota and/or GCG regulations  |                           |                                  |   | 8% to 20%                                   |
| EU countries with no quota or GCG regulations   |                           |                                  |   | 9% to 11%                                   |
| Finland   | 2010                      | >= 1 woman, binding              | GCG 2010  | 12% to 30%                                  |
| Spain   | 2015                      | 40% not binding                  | GCG 2006  | 3% to 15%                                   |
| France  | 2014, 2017                | 20%, 40% binding                 | GCG 2010  | 5% to 30%                                   |
| Belgium   | 2017-19                   | 33% binding                      | GCG 2009  | 6% to 17%                                   |
| The Netherlands   | 2015                      | 30% not binding                  | GCG 2010  | 8% to 25%                                   |
| Italy   | 2015                      | 30% binding                      |   | 2% to 15%                                   |
| Germany   | 2016                      | 30% binding                      | GCG 2009  | 10% to 21%                                  |
| UK  | 2015                      | 25% not binding                  | GCG 2010  | 15% to 21%                                  |
| Denmark   | 2013                      | Flex "quota", not binding        | GCG 2008  | 11% to 23%                                  |
| Sweden  | -                         | -                                | GCG 2004  | 18% to 26%                                  |
| Luxembourg  | -                         | -                                | GCG 2009  | 4% to 11%                                   |
| Austria   | -                         | -                                | GCG 2010  | 6% to 13%                                   |
| Poland  | -                         | -                                | GCG 2010  | 9% to 12%                                   |
| Countries outside EU:   |                           |                                  |   |   |
| Norway  | 2008                      | 40% binding                      | GCG 2009  | 20% to 42%                                  |
| Iceland   | 2013                      | 40% binding                      | -   | 4% to 48%                                   |
| Australia   | -                         | -                                | GCG 2010  | ? to 15%                                    |
| US  | -                         | -                                | GCG 2009  | ? to 16%                                    |
| * For some EU-28 countries (most of the countries that became EU members in 2004) there is no information on 2003. Instead the first year with information is used, which is 2004 in most cases. Simple non-weighted mean of countries. |                           |                                  |   |   |

Sources: Ahern and Dittmar (2012), Smith (2014), Ahern and Clarke (2013), EU Commission (2014a,b), Deloitte (2013), Catalyst (2014).

boards because more alternative perspectives may be discussed and evaluated. Boards with more women tend to act more independently than male-dominated boards, where board members with close relationships to other boards or networks ('old boys club') tend to constitute the majority. Diverse boards, supervisory boards or management boards may in some cases, depending on the type of company, have a better understanding of the market place, or they may imply more legitimacy and a better company image. Furthermore, role model and/or mentoring may have positive effects on the career development of women at lower levels within organisations (Matsa and Miller 2011). On the other hand, diverse boards may experience more conflicts, and their discussions may be more time-consuming and less time-effective than those of more homogenous boards. If a company's (probably male) CEO and executives are reluctant to share key information with demographically dissimilar directors, this may compromise board efficiency (Ferreira 2010).

The results of empirical research into the impact of gender diversity on board efficiency and firm performance is very mixed (Smith 2014). Part of the reason for the ambiguous results is that the studies stem from many different countries with different institutional settings, company structures etc. Secondly, statistical methods and identification of the causal relationship between gender diversity and firm performance is an important issue. This relationship may be subject to two main types of endogeneity problems. One problem is related to omitted variables. For instance, companies with good corporate governance behaviour and HR policies may have more gender diverse boards and tend to perform better. The second problem is reverse causality. Companies who perform well during a given period, for example, may 'take the risk' of hiring a woman for the board. The opposite may also occur, i.e. companies that perform poorly during a period may tend to hire a female CEO or chairman of the board (Ryan and Haslam 2005).

A number of the empirical studies and reports from the Catalyst organisation (see for instance Catalyst 2012; McKinsey & Company 2010), which tend to find a positive relation between women on boards and firm performance, have not explicitly addressed these endogeneity problems. Empirical studies, which apply alternative estimators with and without control for endogeneity problems, document that simple OLS estimates typically tend to be positively biased because of these problems. When applying panel estimates to take account for (time constant) unobserved heterogeneity and IV instruments etc. to address reverse causality, the positive relationship between diversity and performance often disappears, or may even become negative (see for instance Smith, Smith; Verner 2006; Adams and Ferreira 2009).

Female board members do seem to impact the work done by supervisory boards. Adams and Ferreira (2009) find for US boards that female board members tend to have fewer attendance problems, and that having more females on the board also increases the attendance rate of male board members significantly. In the same study it is found that boards with more female directors tend to have significantly higher CEO turnover in companies that are not performing well. The authors conclude that female board members tend to be tougher monitors of CEO performance. Huse, Nielsen and Hagen (2009) studied the board processes based on a survey of Norwegian firms (after the introduction of the quota law). They find that boards with more female directors tend to have better processes and board discussions, which may imply a positive impact on board efficiency.

However, not all studies document a significant difference between male and female directors. When levels of female representation on the supervisory or management board are very low in a country, the impact and behaviour of female directors may be very different from that of the rest of the female population (and more like that of their male peers) because these women constitute a highly selected group of women. Adams and Funk (2012) find that this is, in fact, the case for Swedish women serving on supervisory boards. Swedish female board members were found to have values concerning security, traditions, and risk attitudes that were more in line with those of their male peers than representative of women in general in the Swedish population. Thus, results concerning the impact on gender diversity may be different in countries with a very low rate of female board representation compared to countries with a high representation rate because of factors like quota regulations or other political regulations.

### The empirical evidence from the Norwegian quota

In view of the statistical problems related to identifying the causal impact of female directors on firm performance and firm behaviour, it might be argued that the empirical evidence from Norway is the optimal means of studying the causal impact of gender diversity on firm performance. Norway has experienced an almost perfect ‘natural experiment’ since it was the first country in the world to decide to implement a binding 40 percent gender quota on large listed Norwegian companies in the private sector within a fairly short period of time.

In 2002, the Norwegian minister of Trade and Industry announced in Norway’s largest newspaper *Verdens Gang* that he was, “sick and tired of the old men’s club” and that he wanted to impose a 40 percent quota for females on the largest Norwegian firms’ board of directors (Ahern and Dittmar 2012, 155–156). In 2002, less than ten percent of the board members of Norway’s largest publicly listed companies were women. The law was passed in Parliament in 2003, but with a grace period of two years. If companies subject to the quota failed to reach the 40 percent limit by July 2005, the quota became mandatory. In early 2006, the Norwegian parliament decided (since the 40 percent goal had not been reached by firms), that the quota was to be mandatory as of January 2008. The quota was mandatory for publicly-listed companies (ASA), i.e. large listed companies that are also subject to stricter rules with regard to capital stock and other aspects of board composition (for a detailed description see Storvik 2011 and Ahern and Dittmar 2012). In 2008, all Norwegian ASA companies complied with the quota law: 40 percent of their directors were women!

The research results concerning the impact of the quota law on firm performance seem, at first glance, to be contradictory and to point in opposite directions. According to Ahern and Dittmar, there was a 3.5 percent drop in share prices at the stock exchange for ASA companies without any women on their board following the announcement of the law. Ahern and Dittmar estimate a number of models where they use the fact that the ASA companies subject to the quota law had a different number of women on their boards in 2002 (identification strategy). They find that the law had significantly negative effects on a number of economic performance variables, and that the effects were more negative the fewer the number of women already on the board when the law was announced in 2002, i.e. the companies where the quota law was most binding as a constraint

on board composition experienced the largest negative impact. Matsa and Miller (2013) use a slightly different sample of Norwegian firms and a different identification strategy (they compare to other large Nordic companies as their main identification strategy and analyse the impact after the binding quota law was implemented in 2006). They also find a significantly negative effect on the economic performance of the companies subject to the quota law. According to Matsa and Miller, this is mainly because the companies subject to the quota were less reluctant to lay-off their workers during the cyclical downturn in 2008.

Dale-Olsen, Schöne and Verner (2013) compare the ASA companies with Norwegian private companies that were not subject to the law. They find that for the majority of surviving ASA companies, the law had no impact on economic performance (their outcome measure is the percentile ranking of growth of ROA). For the poorest performing companies, however, they find that the reform had a positive effect. This may correspond to the results found in Adams and Ferreira (2009) that gender diversity has a positive effect in poorly managed companies because female directors tend to be tougher monitors than their male peers on the board.

Thus, the results for the Norwegian quota law are not unambiguous. Part of the reason may be the validity of the identification strategy, i.e. what is the comparison group.<sup>2</sup> Another reason for the apparently different results may be different outcome variables. The share price reaction of the stock market to the quota announcement and political decisions in 2002–2003 may be much more instant compared to the potential impact on labour costs or ROA outcome variable, which will occur much later than at the date of the announcement of the quota law. Additionally, one might argue that stock market reactions are not rational, but merely reflect market ‘prejudices’ or an overshooting reaction. We do not yet know the long-term impact on Norwegian firms’ performance, which may be different from the short run reaction. The labour hoarding behaviour of the companies subject to the quota may, for example, have positive long run effects on workforce

<sup>2</sup> Ferreira (2010) criticises the instrument used by Ahern and Dittmar (2012) for not having a randomly selected control group. The timing of the announcement of the quota law and the anticipation within the firms of the ‘threat’ of a law and the timing of their reaction to this ‘threat’ is the crucial point. Dale-Olsen et al. (2013) analyse the companies that survive as ASA companies and do not give up being publicly listed companies may be a selected group (sensitivity studies, however, indicate that the results are robust to this problem). In Matsa and Miller (2013), the control group critique does not apply, but Matsa and Miller are not able to precisely identify which companies are subject to the quota law. They use information on whether the company is a public or private company as a proxy for being subject to the quota law.

loyalty and image. Companies may adjust over time to the law, and the female board members and the pipeline of qualified women will increase over time since female board members acquire more experience.

This observation points to another potential effect of the quota. The main purpose of the law was to increase the number of women on boards and to reduce ‘old boys’ network’ effects as announced by the Norwegian minister. In that sense the Norwegian quota law was a success. In 2008 the goal was reached and 40 percent of board members were women. However, female directors cannot have been the ultimate policy goal. This target must have stemmed from a more general ambition to get more women into powerful positions in the private sector, and not only to help a limited number of high profile women to obtain more positions on supervisory boards (‘the golden skirts’ discussion). From this perspective, it is debatable whether the Norwegian quota law has achieved its goal. According to Ahern and Dittmar (2012, 170–172), the newly hired women on Norwegian boards were actually different (younger, less experienced as directors or top executives etc.) from the board members who stayed or exited the Norwegian boards during the period up to 2008. On the other hand, the female proportion of CEOs and the number of female chairmen on boards in the large Norwegian companies increased only slightly from about two percent in 2001 to about five percent in 2009. Since the same pattern is found in Denmark, a Scandinavian neighbouring country that has not introduced any quota regulation, it is doubtful whether the quota law has had a spreading effect and introduced more female role models in the Norwegian business sector (Smith et al. 2013). The most recent developments after 2008 do not look promising. According to more recent data from Statistics Norway (2013), there was notably no increase in the female share of directors in private limited companies (ASA companies that were not subject to the quota) or in the female share of top executives (CEOs) of public and private limited companies up until 2013. Only six percent of the 274 public limited companies in Norway had a female CEO (general manager) in 2013 and the share of female CEOs even decreased between 2012 and 2013!

A potential negative effect of the quota law has been the delisting of the ASA companies in order to avoid the quota law. There are clear disagreements in research into this phenomenon. Ahern and Dittmar (2012) and Bøhren and Staubo (2012) find that it had a major effect on the number of firms listed on the stock exchange and as many as 30–50 percent of the ASA companies delist-

ed due to the quota law. Again, the results from various authors seem to differ. Bøhren and Staubo (2012, 22–23) conclude that ‘half the firms choose to exit into an organisational form that is not exposed to the law’ This tendency to avoid costly regulation by changing organisational form varies systematically with firm characteristics. The opposite view is found in Storvik (2011, 40), who argues that only two percent of companies changed their organisational form due to the quota regulation. Her figure is based on telephone interviews with CEOs and chairmen from companies that changed from public to private limited companies. However, one may be fairly critical of this figure since the validity of answers from CEOs or chairmen is questionable, as it may not be optimal for the legitimacy of a Norwegian company to publicly admit that it changed organisational form due to the quota law.

### Implications and conclusion

After many years of almost constant female representation on the boards of directors in large private sector companies, the figures now seem to be changing. From 2003 to 2013, the female share of board members in the largest listed companies in the EU increased considerably. However, the increase mainly took place in countries that had announced or already implemented quota or soft law regulations on the gender composition of supervisory boards. In these countries female representation increased from eight percent in 2003 to 20 percent in 2013. In the rest of the EU countries with no regulations the figures were nine to 11 percent. The mere discussion of guidelines for good governance and (the threat of) quotas seem to have had an impact on female representations in the countries where the debate has been heated and politicians have implemented regulations. This has unearthed a large number of suitable female board candidates in many countries within and outside Europe, and has increased female representation – a transition that probably would not have happened without the (threat of) quota regulations.

The EU figures are still far below the female share of directors on the boards of Norwegian and Icelandic listed companies, where binding quota laws in 2008 and 2013, respectively, prompted a very rapid increase in the number of female directors. The impact of the Norwegian quota on firm performance has been studied intensively and research into the impact of the quota yields conflicting results, mainly because it is difficult to identify what exactly the counterfactual scenario was and which con-

trol groups Norwegian companies subject to the quota law should be compared to. The most reliable studies tend to indicate that there was a negative impact on firm value immediately after the quota was announced in 2002 and implemented in 2006, and the impact was largest for the companies that were most heavily affected by the quota. The Norwegian companies that were subject to the quota law were more reluctant to adjust their labour force during the cyclical downturn after 2007, and therefore incurred higher labour costs. However, for the weakest performing quartile of companies, the quota law seems to have had a positive impact on firm performance. Beside these results, the quota law also implied that a number of public listed companies that were subject to the quota decided to change their organisational structure in order to avoid the quota.

The Norwegian ‘experiment’ is interesting for many reasons. It might be considered a ‘perfect experiment’ to study with respect to the causal link between board gender diversity and firm performance. However, care should be taken about generalising the Norwegian experiences concerning the impact of gender diversity on firm performance and applying them to other countries that have not implemented a quotation and have a much lower level of female representation on their supervisory boards, as is the case in most other countries in Europe. The Norwegian quota was implemented within a very short time period, and initially, in 2002, Norway had a fairly low level of female representation on supervisory boards (less than ten percent). Women who were given directorships in Norway because of the quota were younger and less experienced than women who had board positions before the quota was implemented. Since other countries have been much slower to follow the Norwegian example, and since the female representation level on boards has been gradually increasing, the impact of quota regulations in countries other than Norway may be more positive because the adjustment will be more gradual since the female share has already increased considerably in recent years.

However, one crucial question and condition for the success of the gender quota and soft law regulations remains: will these regulations change the position of women in top management? Will the quota law imply that a much larger proportion of the female talent pool succeeds in rising to top positions in companies, either as directors or as top executives? The ultimate political goal of the quota cannot be that a limited number of women are given attractive jobs as directors, especially since most research studies to date have not documented

any positive causal impact of gender diversity on firm performance. Therefore gender diversity on boards has to be based on arguments in favour of fairness, equal opportunities or the long run argument of a better use of the female talent pool.

In this sense the Norwegian quota-law does not seem to have been a success. Until now the quota has not had much more than a scattered impact in Norway with respect to getting more women into executive positions or directorships in companies not subject to the quota. Here, as well as in the rest of Europe, female representation at the executive and supervisory board level remains low, and women in many cases do not succeed in climbing the career ladder and harnessing the huge human capital investment that they have made. Therefore, quota regulations on top of the company hierarchy and supervisory boards may not be the ultimate answer to these challenges. Politicians probably also have to address the challenges further down in the hierarchy where the pipeline is leaking, i.e. the early careers of young women and the balance between career and household responsibilities if they want to achieve a more balanced gender composition in top management positions in the long run.

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