The attached article, Corporate Governance Update: Gender Diversity on Public Company Boards, was published in the New York Law Journal on September 27, 2012

September 27, 2012

<u>Corporate Governance Update: Gender Diversity on Public Company Boards</u>

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The issue of gender diversity in the corporate boardroom has risen to new prominence in the wake of recent efforts to impose quotas for women directors for companies in the European Union. The EU's recent initiative has provoked controversy not only as to the optimal gender balance of boardrooms but also as to whether a quota system is a fair or effective way to achieve the underlying objective of women's full and equal participation in corporate affairs. In the United States, the relative dearth of women directors on public company boards, and the potential effect on company performance of increased gender diversity, has been a topic of interest in the corporate governance sphere for many years.

The meaningful participation of women at all levels of the corporate hierarchy is an important goal. From a practical perspective, however, we believe that aspects of the European experience demonstrate the downsides of using a quota system to obligate this result. Individual public companies, and the U.S. corporate culture generally, would, in our view, be best served by corporate boards' taking a dedicated, thoughtful and individualized approach to the nomination, election and full integration of women directors. This approach seems likely to yield the most successful substantive result in the short and long term, producing benefits both for corporate performance and the common weal.

<u>EU Quota Initiative</u>

The most recent effort to increase the number of women directors in Europe has been spearheaded by Viviane Reding, the European Union Justice Commissioner and Vice-President of the European Commission. Reding strongly supported a law imposing sanctions on companies that do not have boards composed of at least 40 percent women. The proposed law reportedly would have required Europe's listed companies to meet the quota by 2020; companies with more than 250 employees or 50 million euros in revenue that did not comply would have faced administrative fines or be barred from state aid and contracts.[1] However, the proposal appears to have generated

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[1] *See* Aoife White, "EU Said to Seek 40 Percent Quota for Women on Supervisory Boards," Bloomberg, September 4, 2012.

fatal resistance from EU member states. On September 14, officials of nine countries—including the United Kingdom, which led the effort—signed a letter addressed to Reding and Jose Manuel Barroso, President of the European Commission, indicating their strong opposition to any European-level adoption of binding provisions regarding the number of women on company boards.[2] The signatories have sufficient power to block the proposal under the voting process of the European Union, and other countries, including Sweden and Germany, have also indicated their opposition to such a law.[3]

The opposition letter affirmed the signatories' support for women in executive positions and as public company directors, stating that

> "[t]he myriad barriers women encounter throughout their career are unacceptable from a gender equality point of view [and]…are among the factors preventing the optimal use of the skilled workforce potential."[4]

The signatories noted that "[m]any of us are considering or have implemented various and differing national measures…to facilitate raising the proportion of women in boardrooms" but contended that "[t]hese efforts must be granted more time in order to establish whether they can achieve fair female participation in economic decision-making on Europe's company boards."[5] Therefore, the signatories concluded:

> "[A]ny targeted measures in this area should be devised and implemented at [the] national level. Therefore, we do not support the adoption of legally binding provisions for women on company boards at the European level."[6]

The proposed law is due to be published in draft form next month. A European diplomat reportedly said that many of the countries opposing the proposed law do not necessarily want to scuttle it completely but do want to ensure that national

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[2] Letter to President Jose Manuel Barroso and Vice President Viviane Reding, European Commission, from Totyu Mladenov, Bulgarian Minister of Labour and Social Policy, et al., September 14, 2012. The letter was also signed by officials from the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, the Netherlands, and the United Kingdom ("Opposition Letter"). Germany indicated its support for the views contained therein in a subsequent letter to U.K. officials. *See* "Germany joins EU group against women's quota," The Local, Sept 15, 2012.

[3] *See* James Fontanella-Khan, "UK musters support to block EU women quota," Financial Times, September 16, 2012.

[4] Opposition Letter, *supra note 2.*

[5] *Id.*

[6] *Id.*

governments retain influence or control over enforcement of quotas.[7] In any event, the proposed legislation has a long road before it would be approved and have the effect of law: All 27 EU commissioners must agree on the proposed law before a draft is published, and the law then must be approved by national governments as well as the European Parliament.[8]

Impact of Quota Legislation

Several European countries have implemented quotas at the national level for women directors on public company boards, including Norway, France, Italy, Spain, and the Netherlands.[9] In 2003, Norway passed a law requiring that at least 40 percent of public company board seats be allocated to women. Covered companies were given five years to comply with the law, and the proportion of women directors rose from 9 percent at the time of implementation to the current average of just over 40 percent.

It is important to separate the effect of quota legislation from the effect of gender diversity on company boards. While the latter has been shown to be beneficial to corporate performance, there are indications that the former is a suboptimal way to achieve those benefits. A study of the aftermath of the Norwegian law showed that not only did the quota requirement cause a significant drop in stock price at the announcement of the law, but the quota then "led to younger and less experienced boards, increases in leverage and acquisitions, and deterioration in operating performance."[10] This may be due in part to the fact that the quota requirement contained a relatively short timeframe in which Norwegian companies had to find and elect female directors, resulting in a drop in the average quality of board members.

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[7] *See* Stephen Castle, "European Plan to Put More Women on Boards Runs into Opposition," The New York Times, September 17, 2012, *available at* www.nytimes.com/2012/09/18/business/global/18iht-boards18.html.

[8] *Id.*

[9] *See* Brian Groom and Ines Burckhardt, "Business opposes quota of women directors," Financial Times, September 4, 2012.

[10] Kenneth R. Ahearn and Amy K. Dittmar, "The Changing of the Boards: The Impact on Firm Valuation of Mandated Female Board Representation," Quarterly J. of Economics, 2012, vol. 127(1): 137-197, May 20, 2011 (First Draft March 18, 2009, Current Version August 18, 2011), *available at* papers.ssrn.com/sol3/papers.cfm?abstract_id=1364470.

Effect of Women Directors

By contrast to the results of the Norway study, a 2012 worldwide study of the nearly 2,400 companies in the MSCI ACWI[11] by the Credit Suisse Research Institute showed that from December 2005 to December 2011, large-cap companies with women directors outperformed peers with no women directors by 26 percent and small- to mid-cap companies with women on the board outperformed their peers with all-male boards by 17 percent in that period.[12] The study also found that companies with one or more female board members experienced higher returns on equity, lower leverage, better growth, and higher price/book value multiples.[13] Some directors have opined that the significant increase in participation by women "professionalized" boards by contributing to a more pleasant, formal atmosphere at meetings, and some commentators view the policy as having "paved the way for women to influence corporate decision making."[14]

While other studies have reached mixed conclusions regarding the role of women in the boardroom,[15] there are many possible reasons why the full participation of women on company boards could contribute to stronger performance. The Credit Suisse report identifies seven of these, described in detail in the report itself.[16] First, the appointment of women directors may be an indication that a company is already

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[11] The MSCI ACWI Index is defined as follows:

"The MSCI ACWI Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 45 country indices comprising 24 developed and 21 emerging market country indices. The developed market country indices included are: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the United Kingdom and the United States. The emerging market country indices included are: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Korea, Malaysia, Mexico, Morocco, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, and Turkey (as of May 30, 2011)." MSCI, http://www.msci.com.

[12] Credit Suisse Research Institute, "Gender Diversity and Corporate Performance," August 2012, at 12, *available at* infocus.credit-suisse.com/data/_product_documents/_shop/360145/csri_gender_diversity_and_corporate_performance.pdf.

[13] *Id.* at 3.

[14] Agnes Bolso, "Ignore the doubters. Norway's quota on women in the boardroom is working," The Guardian, July18, 2011; *see also* Global Corporate Governance Forum *Focus 9,* "Women on Boards: A Conversation with Male Directors" ("Women on Boards"), 2011 *available at* www1.ifc.org/wps/wcm/connect/b51198804b07d3b2acabad77fcc2938e/Focus9_Women_on_Boards.pdf?MOD=AJPERES.

[15] *See* Steven M. Davidoff, "Seeking Critical Mass of Gender Equality in the Boardroom," The New York Times Dealbook, September 11, 2012 ("Critical Mass"), *available at* dealbook.nytimes.com/2012/09/11/seeking-critical-mass-of-gender-equality-in-the-boardroom/.

[16] "Gender Diversity and Corporate Performance," *supra note 12*, at 17-19.

fundamentally sound and looking to improve from a position of strength. Second, there is evidence that greater diversity on a team can enhance the performance of both the majority and minority groups, improving average outcomes overall. Third, gender diversity can improve the overall level of leadership skills, as studies have shown that women excel in defining responsibilities clearly and mentoring and coaching employees. Fourth, deliberately expanding director candidate searches to include women provides access to a significantly wider pool of available talent. Fifth, a gender-mixed board may have a better understanding of the consumer preferences of households, particularly in sectors where women make many of the spending decisions. Sixth, academic research has demonstrated that having women on a corporate board improves performance on corporate and social governance metrics for companies with weak governance. Seventh, women have been shown to be generally more risk-averse than men, which may explain in part why companies with women directors in the Credit Suisse study were less leveraged on average than their peers; the study notes further that "lower relative debt levels have been a useful determinant of equity market outperformance over the last four years."[17]

Strikingly, the Credit Suisse study showed that almost all of the share price outperformance of companies with women directors came after 2008, during the financial crisis period and its aftermath.[18] These companies exhibited less volatility in a falling market and delivered higher returns during this period, suggesting that women directors contribute to a stronger defensive profile, including better risk management and downside control.[19] One recent study of Israeli companies concluded that boards with three or more women directors were roughly twice as likely to request further information and to take an initiative, leading to higher return on equity and net profit margins compared to peer companies.[20] Moreover, both men and women directors were more active when at least three women directors were in board meetings, and women were more likely than their male counterparts to take actions on supervisory issues.[21]

In addition to enhanced corporate performance, there are other reasons to favor the full participation of women in boardrooms: the values of societal fairness, gender equality, and corporate meritocracy, for example, or the desire to create a positive culture of valuing the contributions of each individual. While quotas provide a relatively quick fix to the problem of gender imbalance in the boardroom—and some politicians and commentators have expressed frustration with the rate of voluntary action absent

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[17] *Id.* at 19.

[18] *Id.* at 6.

[19] *Id.*

[20] *See* Miriam Schwartz-Ziv, "Does the Gender of Directors Matter?" Working Paper, June 23, 2011 (last revised September 7, 2012), *available at* papers.ssrn.com/sol3/papers.cfm?abstract_id=1868033.

[21] *Id.*

legal requirements[22]—they do so in an artificial manner that could create resentment and board dysfunction. Moreover, forcing quotas of women directors prioritizes gender diversity over all else, potentially at the expense not only of director quality but also of other types of diversity that may be valuable to corporate performance.

Business Community View

The European business community, while expressing support for increasing the number of women directors, generally opposes European-level quotas as means of doing so. BusinessEurope, the largest organization of employers in the European Union,[23] issued a position paper this past May outlining views similar to those expressed in the UK-led opposition letter described above.[24] The paper supports a voluntary approach to increasing diversity, both in terms of gender and in terms of talent, skills and experience. BusinessEurope opposes mandatory European-level initiatives and, in particular, one-size-fits-all quotas "which disregard the highly diverse conditions in different sectors/companies and do not take into account the way corporate boards function and are renewed."[25]

It appears that companies are willing to take voluntary measures to increase the number of women directors on their boards. They are aided in their efforts by organizations such as the Professional Boards Forum, which helps chairmen in Norway and the United Kingdom find qualified women to fill independent director positions,[26] and the 30 Percent Club, a group of chairmen of U.K. companies who are working toward a goal of 30 percent female representation on U.K. boards.[27] The 30 Percent Club's mission statement highlights the view that meaningful participation by women cannot be mandated by top-down quotas but instead must be the result of concerted, long-term efforts to encourage women to succeed in corporate careers. The

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[22] *See, e.g.*, Stanley Pignal, "Commission to push quota for women directors," Financial Times, March 4, 2012 (quoting Viviane Reding as saying, "I am not a fanatic about quotas…but I like the results quotas bring about."); Christine Murray, "Quotas for women directors are the way forward," BreakingViews, September 5, 2012 (opining that without mandatory quotas and tough sanctions, companies are too slow to add female directors to boards).

[23] BusinessEurope claims to represent, through its 41 member federations, more than 20 million companies from 35 countries. The organization describes its mission as "to ensure that companies' interests are represented and defended vis-à-vis the European institutions with the principal aim of preserving and strengthening corporate competitiveness." *See* BusinessEurope, http://www.BusinessEurope.eu.

[24] BusinessEurope Position Paper, "Gender Balance in Boards of Directors," May 25, 2012, *available at* ec.europa.eu/justice/newsroom/gender-equality/opinion/files/120528/all/63_en.pdf.

[25] *Id.* at 1.

[26] *See* Professional Boards Forum, http://www.boardsforum.co.uk.

[27] *See* 30 Percent Club, http://www.30percentclub.org.uk.

organization issued the following statement last month, as controversy over the potential EU quota legislation was brewing:

> "[T]he only way to achieve better gender balance at all levels in the UK's leading companies is to ensure the pipeline of female talent is developed from an early stage. In light of recent commentary on the lack of progress at the Executive Board level, the group argues that a concerted effort to develop the pipeline of female talent…will help achieve better gender diversity in senior roles at UK companies."[28]

The 30 Percent Club is no doubt correct that improvement in the number and quality of corporate positions held by women will "trickle up" into the boardroom; the full integration of women into the boardroom and executive suites of major public companies is a goal with both long- and short-term components.

U.S. Boards' Gender Diversity

According to GMI Ratings' 2012 Women on Boards Survey, the United States currently ranks 11th out of 45 countries in terms of gender diversity on public company boards, with an average of 12.6 percent women on S&P 1500 boards.[29] Because there are fewer women on the boards of smaller companies, only 11.6 percent of Russell 3000 directors are women.[30] In addition to these data points, a GMI study from July 2012 also found significant differences among states and regions, largely driven by the concentration of specific industries in certain areas.[31] The percentage of women on U.S. boards increased by only 0.5 percent in the period 2009 to 2011.

The United States has not yet seen a strong movement toward quotas or other legal requirements in terms of gender diversity on boards. U.S. Securities and Exchange Commissioner Elisse B. Walter, speaking last week at the Third SAIS Global

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[28] 30 Percent Club, "Development of senior female talent is a key longer term goal and a growing priority for companies," August 29, 2012, *available at* www.30percentclub.org.uk/press/30-club-recognises-strong-progress-on-non-executive-directorships-%e2%80%93-inevitably-not-yet-matched-by-executive-pipeline/.

[29] GMI Ratings 2012 Women on Boards Survey, March 2012, at 11, *available at* http://www.gmiratings.com. Citing Catalyst (a nonprofit organization devoted to furthering women in business), Steven Davidoff notes that American companies have the fourth-highest average of women directors in the world, noting that women make up 16 percent of the average board of a Fortune 500 company in the United States. "Critical Mass", s*upra 15; see* Catalyst, "Women on Boards," August 2012, *available at* www.catalyst.org/publication/433/women-on-boards.

[30] GMI Ratings, "Variation in Female Board Representation Within the United States," July 2012, at 2, available at www3.gmiratings.com/home/2012/07/variation-in-female-board-representation-within-the-united-states-lamb-and-gladman/.

[31] *Id.*

Conference on Women in the Boardroom, argued in favor of action at the shareholder level. She pointed out that strong disclosure standards help provide investors the information they need in order to exercise their "voice" to encourage companies to increase the diversity of their boards. Commissioner Walter cited evidence that the SEC's rule on disclosure of director qualifications that first applied in 2010 is leading to more detailed discussions regarding the composition of boards, and as a result, investors are more engaged in the issue.[32]

As in Europe, the United States has organizations that are committed to increasing the number of women on corporate boards. DirectWomen, for example, is a program designed specifically "to identify, develop, and support…accomplished women attorneys to provide qualified directors needed by the boards of U.S. companies, while promoting the independence and diversity required for good corporate governance."[33] Through strategies designed to help women advance in their careers and come to the attention of executive search firms and other corporate leaders, DirectWomen and groups like it are effecting meaningful change at the individual company level.

Many positions on U.S. public company boards are filled by search firms and companies can provide these firms with specific requests as they seek additional diversity on their boards.[34] These firms are working hard to develop a larger group of qualified women candidates who are actively seeking board positions. In our experience, these search firms are very successful at helping public companies increase gender diversity on public company boards.

The Credit Suisse Research Institute report indicates that increasing the number of women board members can result in an improvement in the quality of directors and many other positive effects for companies. Doing so through voluntary

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[32] U.S. Securities and Exchange Commissioner Elisse B. Walter, "Remarks at Third SAIS Global Conference on Women in the Boardroom," September 20, 2012, *available at* www.sec.gov/news/speech/2012/spch092012ebw.htm. *See also* Securities and Exchange Commissioner Luis. A. Aguilar, "Diversity in the Boardroom is Important and, Unfortunately, Still Rare," September 16, 2010 (speech at SAIS Center for Transatlantic Relations: Closing the Gender Gap: Global Perspectives on Women in the Boardroom) *available at* www.sec.gov/news/speech/2010/spch091610laa.htm ("While the SEC's new rule focuses only on disclosure, an indirect effect of putting a focus on a board's diversity is that boards may decide to add, or add more, minorities and women as directors. It is reasonable to expect that the process of focusing on their diversity policy and its effectiveness could likely result in greater diversity. I personally believe that companies that expand their search for new directors to include more women and minorities will find a breadth and depth of talent that will serve to improve their performance and increase the wealth of their investors.").

[33] *See* DirectWomen, http://directwomen.org.

[34] *See* "Women on Boards", *supra note 14*, at 35 (comments by Peter Browning); *see also* Aguilar, "Diversity in the Boardroom is Important and, Unfortunately, Still Rare," *supra note 32* ("a nominating committee should follow policies and procedures that require the proactive development of a diverse slate of candidates in advance of a board opening becoming available.").

action, which takes into account the individual circumstances of each company, should be the best way to achieve these benefits without the downsides of mandated quotas and artificial timeframes. As the issue of gender diversity in the boardroom gains prominence, as the benefits to having women directors become better understood, and as resources such as director databases increase in utility, it seems likely that U.S. companies will pursue the goal of greater gender diversity with increasingly successful results in the boardroom and for investors.