Links Between Gender Diversity and Board Conduct

Interview by Manini Sheker

In 2001, Enron filed for bankruptcy after it was revealed that it had concealed large debts, giving investors a false image of the company. How did Enron's collapse provide the impetus for scrutinizing the conduct of boards and corporate governance in general?

When the Enron fiasco happened, people really started asking, 'Where was the board? How did it allow this to happen?' People were really surprised that the board did not notice problems, and I think that prompted those interested in the collapse to examine what was going on at the board level in general.

Some people who analyzed the conduct of the Enron board concluded that it was complacent, and that it did not bother to question much of what was going on. There was talk about 'groupthink' — the phenomenon where group members accept conclusions and come to decisions fairly quickly, without much debate or challenge of the prevailing opinions. This can happen because group members want to avoid conflict or because they actually do have very similar views, and they want to get things done and over with.

All of this left many of us asking, 'What can be done so that boards in general are not subject to groupthink? If boards had directors that were different along some key dimensions, perhaps we would get better outcomes?' This prompted me to examine whether certain demographic characteristics lead to better governance outcomes.

Why is it so valuable to have a board that is diverse in terms of gender?

Research shows that when group members are similar along any key dimension, this correlates with the way they think. So, to the extent that there is no gender diversity on a board, chances are that there will be less diversity of opinion and that people won't engage in vigorous debates or question things.

The other reason why gender diversity is really important is that 50 per cent of the population is female, and in many companies, half of the employees, customers and

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other stakeholders are female. This raises the question of how a board can make well-informed decisions if there is no one representing voices of half of the stakeholders.

How does the gender diversity of a board affect the quality of financial reporting and the likelihood of financial misconduct?

My research suggests that when boards do have female directors, they tend to have better financial reporting quality and also engage in less financial misconduct. When we looked at a firm with at least one female director and compared its results in a given year to its results in the closest year without any female directors on the board — holding other firms characteristics constant — we found that the quality of financial reporting was better in the years with female directors on the board.

Why do boards with female directors fare better?

I cannot conclusively answer that, but I have explored some widely held beliefs about why this is the case. I examined, for instance, whether differences in expertise, independence or diligence between male and female directors make any difference, and I found that those do not seem to be the essential explanatory factors. This leads me to believe that the benefits of having female directors come from the fact that their presence changes the dynamics of a board — the way the board members interact with each other, ask questions and engage in discussions.

Does the positive effect of the presence of female directors on financial reporting hold equally for other governance-related tasks?

My study focuses only on the financial reporting side, but other studies have looked at other governance tasks, and some have found that having female directors leads to better outcomes. It seems certain that, at a minimum, firms are no worse off, in terms of governance outcomes, by having more diverse boards.

You make an interesting observation in your paper that boards with more than one female director outperform boards with only one female director, but boards with more than two female directors do not exhibit incremental improvements in performance. Why is that?

The reason that boards with female directors perform better is likely not due to the fact that women are better along some particular dimension; if that were the case, we would expect that every additional woman that is added to a board would provide incremental benefit. On the other hand, if boards with female directors perform better because gender diversity changes board dynamics, as I suspect, then adding some women to a board will be sufficient to change the board dynamic. But adding additional women after that might not actually have any incremental benefit, either because the dynamics have already changed, or because it may take away from the benefit provided by other forms of diversity. We would not be better off having all female boards — it's diversity of perspective that matters. We need diversity along many dimensions, and gender is just one of them.

Entrusting power to a diverse set of people does not necessarily ensure that the best decisions will be made. Would you agree?

Yes. Studies show that diverse groups have a harder time reaching consensus because everyone has an opinion, so coming to a decision can be harder. Anecdotally, I have seen this on some boards, too. It often leads to longer meetings and circular discussions. But at a minimum, having diverse representation allows for people to say, 'Hey, you haven't thought about this' or, 'What if we think about this issue in this particular way?' It provides the ability to look at things from different perspectives, and if you don't have that, you

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are more likely to have blind spots and to miss things that are really critical.

Would you say that gender diversity matters more in firms with weak governance structures?

Several studies show that diversity, at least in terms of gender, does matter more in poorly-governed firms. If firms are already well-governed, perhaps having diversity of opinion does not matter as much; deliberations will happen no matter what, because the executives and directors truly care about the firm outcomes. However, in my research, I document the benefit to both types of firms — those that are poorly governed and those that are well-governed.

Corporate psychologist Jason Schultz points out that "Just as character matters in people, it also matters in organizations." Is there a moral case to be made for advocating for the importance of diversity in corporate governance?

I believe so. Sometimes people make too much of the economic case for diversity, and I understand where that comes from. At the same time, however, as long as there are no negative consequences economically to having diversity, the economic argument should really be mute. There should not be a burden of proof that 'diversity improves firm performance' before we start advocating for it. We are not making firms any worse off by advocating for diverse boards; that is fairly certain from the research. We are not hiring underqualified candidates just to meet some diversity quota. To the extent that there is no downside to diversifying boards, then it does become a moral argument that it is 'the right thing to do'.

How might diversity in leadership and governance increase trust among the communities and employees that a firm serves?

It definitely can, especially when it comes to employees. Many firms talk about diversity, but unless they can demonstrate their commitment by providing actual pathways for their employees to rise to leadership roles, it's nothing more than cheap talk. And employees are smart enough to figure that out. You can talk about your commitment to fostering a culture where women are supported and enabled to reach the top, but if there is nobody at the top who looks like them, how credible is that?

In many cases, especially in service industries like law and consulting, firms are desperate to make it to all the lists of 'Best Employers for Women'. But if you look at their executive boards or their practice leaders, it is hard to find even a single woman in the most important roles. If you want to hire the best new female associates, you must credibly signal to them that you have their best interests in mind and that you are committed to fostering an environment where they can succeed. Actions speak louder than words. *RM*

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