Women on board: Does forced diversity hurt firm performance?

February 9 2010

(PhysOrg.com) -- New SEC rules will require public firms to disclose what role, if any, diversity plays in appointing members to their corporate boards, but University of Michigan researchers say any forced restructuring of boards in the name of equality could hurt companies.

"Boards are chosen in order to increase shareholder wealth," said Amy Dittmar, associate professor of finance at Michigan's Ross School of Business. "Placing restrictions on the composition of a board will reduce value."

Currently, there is no SEC-mandated definition of what constitutes diversity and there are no restrictions on who companies can appoint to their boards. Corporate nominating and governance committees may consider such factors as professional experience, education, gender, race or national origin.

A new study by Dittmar and Ross School colleague Kenneth Ahern, assistant professor of finance, analyzes the impact of a 2003 Norwegian law requiring all public-limited firms to have at least 40 percent representation of women on their boards of directors by 2005. At the time, only 9 percent of board seats in Norway were held by women. After voluntary compliance failed, the law became effective Jan. 1, 2006, with a two-year transition period. Firms that did not comply by January 2008 would be forced to dissolve.

Using a panel of 130 publicly listed Norwegian firms from 2001 to

2007, the researchers found a negative impact of the mandated board changes on firm value—a result that may be applicable to the United States and Britain since Norway's system of governance is similar. A few other European countries are also considering gender quota laws or initiatives.

Dittmar and Ahern found that the stock price of an average firm dropped 2.6 percent in the three days following the first announcement of the new law and 5 percent for firms that had no women on their boards at the time of the February 2002 announcement.

The researchers also used a common market-based measure of corporate governance to determine firm value: Tobin's Q, a ratio of a company's market capitalization to the replacement cost of its assets (the sum of total assets and market equity less common equity divided by total assets).

They found that when a firm experienced at least a 10-percent increase in the proportion of women on its board, Tobin's Q dropped 18 percent.

"The negative effect of the regime shift supports the hypothesis that board structure affects value," Ahern said. "Firms that were required to make the most drastic change to their boards also suffered the largest negative returns. Our results indicate that boards do matter and that constraining the selection of board members has a large negative impact on value."

Dittmar and Ahern are quick to point out, however, that a loss in firm value was not caused by the gender of the new board members, but rather by their young age and lack of high-level work experience. In fact, gender effect is not significant once you account for these other experience-related differences, they say.

"The constraint imposed by the 40-percent women quota led firms to recruit women board members that were younger and had different career experiences than the existing directors," Dittmar said. "It is reasonable to suggest that these changes led to decreases in firm value because new directors did not have the same monitoring or advising capabilities of the other directors before the imposed change.

"When firms were free to choose directors before the rule, they tended to choose women that were similar to men directors. This is consistent with the idea that the large demand and small supply for women directors after the adoption of the 40-percent quota forced firms to choose directors that they would not have chosen otherwise."

Provided by University of Michigan

Citation: Women on board: Does forced diversity hurt firm performance? (2010, February 9) retrieved 26 April 2024 from https://phys.org/news/2010-02-women-board-diversity-firm.html

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