Gender quotas for boards: how to destroy European Competitiveness

By Theo Vermaelen

The following is a reply to the INSEAD Knowledge News Alert "Women on Boards: No Quotas…Yet" from INSEAD Finance Professor Theo Vermaelen, who is expressing his personal viewpoint.

In the middle of the economic crisis one would expect that Eurocrats would find something more constructive to do with their time than imposing absurd laws such as requiring women to make up at least 40% of listed European companies' boards. This law is the brainchild of Ms. Viviane Reding, the Commissioner for justice, fundamental rights and citizenship.

The fact that there are fewer women than men on boards is not necessarily proof of injustice or male chauvinism as Ms. Reding seems to imply. Typically, board members are CEOs of other companies and it is a fact that most CEOs are men. Unless if Ms. Reding wants also to put a gender quota on CEOs, the board gender quota will put more people on boards without leadership experience in business.

Given today's massive unemployment in Europe and fight for survival, any regulation should pass a cost-benefit test: what are the consequences of the regulation for European competitiveness and growth? After all, a board is not a social club. Board members are chosen by shareholders who expect them to maximise shareholder value.

Consequences?

The proponents of the law could argue that there are no negative consequences, quite the contrary: male chauvinist boards systematically discriminate against highly qualified women, so replacing men by women will increase shareholder value. If this was the case, one would expect activist hedge funds to take stakes in all-men boards, change the gender composition and make money in the process. In other words, if male chauvinism was inefficient, it would create arbitrage opportunities and there would be no need for regulation. However, I am not aware of any activist hedge fund that is involved in such a strategy.

The idea for gender quotas comes from Norway that imposed them in 2004. Evidence scheduled for forthcoming publication in The Quarterly Journal of Economics shows that mandatory gender quotas in Norway destroyed shareholder value in the short- and long-run. It is the work of two university finance professors, Kenneth Ahern, currently of UCLA's Marshall School of Business and Business Economics, and Amy Dittmar of the University of Michigan's Ross School of Business – one of the leading female finance scholars in the world.* The Norwegian case provided an ideal experimental setting as the announcement of the law was unexpected. On the day of the announcement stocks of companies without women on the board fell by 3.5 percent while stocks companies with women on the board did not fall. Examining subsequent performance the authors conclude that a forced 10 percent increase in women representation led to a 12.4 percent decline in Tobins' Q. On average, the size of the boards did not increase which means that men were fired to make room for women. They find that the law brought in less experienced and younger board members, as expected. Another explanation could be that women typically care more about stakeholder value than shareholder value.** Regardless, the authors conclude (page 5) that:

"the results suggest that the constraints imposed by the law had a large negative effect on firm value".

The findings can be explained by the fact that in Norway, a very socialist country, shareholders don't matter so these costs are irrelevant. But then this should be made clear to European investors up front: we are going to put people on the board who don't care about your interests or don't know how to create shareholder value. These investors can then decide whether they want to hold stocks in companies with such a new governance model. I expect that Europe will then follow the Norwegian example: before the law was enacted, there were 600 publicly traded companies in Norway. Three years later the number was reduced to 300, reflecting the fact that companies responded to the law by going private, a fact also documented by Ahern and Dittmar (2012). So an honest argument of the proponents should be: we know that this is economically inefficient, it will destroy our capital markets, but we don't care as this is all about fairness and equality.

The European Union was originally motivated as a union to promote free enterprise and trade. Today it's obvious that we moved far away from this objective. Regulating all aspects of people's lives and using corporations to promote political pet projects, regardless of costs, seems to be the new mantra.

* *"The changing of the boards: the impact on firm valuation of mandated female board representation", by Kenneth Ahren and Amy Dittmar, Quarterly Journal of economics, 2012 (forthcoming).*

** *"Shareholders and stakeholders: how do directors decide?" David Matsa and Amalia Miller, Strategic Management Journal (forthcoming).*

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