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IlLUminate Blog Transcript Parveen Gupta and Heibatollah Sami on the Effects of Boardroom Gender Diversity

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ANNOUNCER: 00:00	[music] This podcast is brought to you by IlLUminate, the Lehigh Business blog. To learn more, please visit us at business.lehigh.edu/news.
JACK CROFT: 00:13	Welcome. I'm Jack Croft, host of the IlLUminate Podcast for Lehigh University's College of Business. Today is May 2nd, 2022, and our guests are Parveen Gupta and Heibatollah Sami, who have coauthored a study examining the relationship between boardroom gender diversity and long-term firm performance. The study was published in the International Journal of Disclosure and Governance. Dr. Gupta holds the William L. Clayton Distinguished Professorship in Accounting at Lehigh's College of Business. He is nationally recognized in Sarbanes-Oxley, corporate governance, financial disclosure and internal control, audit committee effectiveness, and enterprise risk management. Thanks for being with us today, Parveen.
PARVEEN: 01:02	Thank you, Jack.
CROFT: 01:04	Dr. Sami holds the John B. O'Hara Professorship in Accounting. His research interests include accounting and auditing regulations, quality of accounting numbers, and implications of accounting numbers for capital markets from the U.S. and international investors' perspective. It's good to have you with us today, Sami.
SAMI: 01:25	Thank you, Jack. Happy to be here.
CROFT: 01:27	Now as the study you both coauthored notes, efforts to increase female representation on corporate boards has gained considerable momentum in recent years, not only in the United States, but internationally as well. What are some of the more significant examples of steps that have been taken to promote greater gender diversity in the corporate boardroom?
PARVEEN: 01:51	Of course, in our paper, we go through a number of steps that motivated us to examine this study. But I will mention a couple here and give you a little bit update, because since the publication of the paper, a couple of things have changed. Number one, the SEC recently approved Nasdaq rules, which would require all Nasdaq-listed companies beginning 2023 to have at least two diverse directors, one female and one underrepresented minority. If a company is not able to meet this requirement for some reason, in order to list on Nasdaq, they will be required to explain why, which is very interesting to us because it kind of reminds me of the comply or explain approach that is currently utilized to enforce governance in the United Kingdom.
PARVEEN: 02:59	By the way, in this context, Nasdaq is offering free board recruiting services for one year to help companies achieve this goal. The second other important current development in this area is Goldman Sachs came out a couple of years ago and said that they will not take companies public unless they have at least one diverse board member. So effective July 1, 2020, they made that announcement, and they are saying that by 2021 or even later, they're going to bump up this requirement to two. So these are two significant efforts that are currently underway in addition to the ones that we have mentioned in our paper. I'll conclude by saying a last point, which is, in our paper, we talk about a very interesting law that was passed by the state of

California which required that all the companies which are registered in the state of California should have boardroom diversity. Very recently, that particular law was struck down. So that is a very new development. But suffice it to say, a lot of efforts are underway in order to increase diversity in the boardrooms of the U.S. public companies.

SAMI: 04:28

Okay. Jack, I just want to add a couple of things to what Parveen said. That is, internationally also, European Union, actually since 2020, they have a 40% cut-off for each gender as of 2020 for nonexecutive directors. Also, European Commission made a statement promoting the discrimination in favor of women when the companies are hiring directors.

CROFT: 05:07

As you reviewed the literature, what are some of the most commonly cited benefits you found attributed to increased gender diversity on corporate boards? A lot of the arguments that we've seen, particularly in the popular press, are that the more diversity you have in terms of background, experience, gender, and the rest, that you get different perspectives and it makes for better corporate governance. What were some of the specific benefits that you found in the literature as you were starting this?

SAMI: 05:46

There are many benefits mentioned in the literature, such as diverse critical thinking, which leads to a more proactive business model and as a result, help improve corporate performance. And then European Union has got a fact sheet that cites the benefit of gender diversity, which includes improved company performance, higher quality decisions, improved governance and ethics, and better use of talent, too. All of these, mind you, is going to usually improve corporate performance. Also, usually, literature indicate that gender-diverse boards act as tougher monitors and are better at mitigating agency conflicts.

SAMI: 06:44

Now note, agency conflicts refer to the fact that the managers are trying usually to maximize their own compensation and their own welfare, and sometimes they do it at the expense of shareholders. On the other hand, shareholders want to maximize their own benefit. So gender diversity mitigates this agency conflict and make sure that the managers, whatever they are doing is going to improve shareholders' wealth. And also, as a result, it reduces agency costs. And also literature shows that they engage in constructive dissent a lot of time. Additionally, studies show that there is significant correlation between number of female directors and corporate revenues, significant positive impact of fraction of female directors on firm value.

SAMI: 07:47

In other words, the firm value increases. Positive impact on financial indicators of firm performance such as return on assets and return on equity. And ultimately, better economic gains. So those are different benefits that are mentioned in the literature.

PARVEEN: 08:07

Jack, I was wondering if I could add a point to that?

CROFT: 08:10

Sure.

PARVEEN: 08:12

My colleague, Sami, is talking about the economic side of the things. And I will add one angle, which is certainly not in our paper because we are professors of business. From a social justice viewpoint also, there's a lot of discussion on this issue. And I think the critical aspect is companies are trying to make sure that their board of directors look like the customers that they are serving. Customers are demanding the demographic diversity in the boardrooms in order to feel valued, and there is a progressive movement in that direction. So I think that's another particular reason that is also becoming very important in the social justice literature.

CROFT: 09:07 Your study specifically looks at zeroing in on the long-term impact. And there's obviously been a lot of other studies that you've just done a good job citing here. But why did you decide to zero in on the long-term impact?

PARVEEN: 09:26 Yes. You are right when you observe that there are lots of studies that have looked at this issue in the academic literature. The reason we became interested in this topic, obviously, is as we talked about in the very beginning, some of the new developments which are occurring across the world and various legislative bodies are getting involved. So the issue is certainly becoming important by the day. So that caught our attention. Now when designing the study, the reason we focus on the long-term impact is because there is a lack of studies with regard to assessing or understanding the long-term impact of these changes in the composition of the board.

PARVEEN: 10:25 And the very basic reason there is that it takes time for performance to show up once you install female board members or diverse board members. A lot of the studies that we examined are looking at impact at a fairly short interval. And in our study, we are looking at T+3 [years] and T+5 [years] kind of a scenario in order to understand. And finally, there are lots of mixed and inconclusive results with regard to the prior studies that we wanted to address also in our study. Last but not least - it's a bit technical, so I will not go into too much detail - we also try to address the endogeneity issues which prior studies have ignored, and that has to do with the causality in both directions of the variables being studied.

SAMI: 11:27 Parveen mentioned the directional effects, and that's right. That is, the corporations that are performing well, they are profitable, they are doing very well. In order to show the good profitable corporation, to signal their equality, a lot of time, they try to diverse their boards and hire women as directors to signal their equality. But at the same time then, the women directors also contribute to the profitability of the companies and impact the performance of the company in both financial and nonfinancial areas. That's why there is a two-way relationship between them. And in order to-- that's called endogeneity. And to control for it, you have to do what's called two-stage least squares analysis to take care of that problem.

CROFT: 12:20 Now you mentioned that looking at both the financial and nonfinancial performance. So let's take those one at a time here. First, what is included in nonfinancial corporate performance, and briefly, how did you go about measuring that?

SAMI: 12:39 The database that we use is a firm's corporate social responsibility scores that is published-- I mean aggregated by KLD database, in that database, which is produced by a risk matrix group. And in this database, they evaluate the corporate social responsibility and assign a score to different elements of the corporate social responsibility [CSR] in five areas. And then also, they provide an overall CSR score. So our main measures are these five areas and the overall CSR scores. Now let me explain each one of these five areas. One is the environment. And when they are measuring it-- by the way, before we get to the environment is they evaluate the strengths.

SAMI: 13:40 And when a company has got any strength in elements of any one of these, they assign a positive score to it. And when they have a weakness, then they assign a negative score to it. So starting with the environment is one element that they measure. And to measure the environments for the corporation, the environmental effect, they evaluate 15 items such as, for example, pollution prevention, emissions, recycling, clean energy, etc. There are 15 of them. And then so the second area, the element is employee relations. In the area of employee relations, they measure 12 items. They evaluate 12 items to measure the employee relations, and that includes items such as relations with the union, health and safety issues, whether the company really provide a safe and healthy environment for the employees to work, profit sharing, and things like that.

SAMI: 14:51

And then in the corporate-- the third one is corporate governance. And in this area, they evaluate 11 items, which is proper directors' and officers' compensation, whether there is a procedure for determining their compensation, independent directors, and things like that. Whether they have independent directors on the board and how many and what percent are independent rather than being selected from the internal executives of the company. And then the fourth one is community, the corporation's relationship with the community. And they evaluate 13 items in this area which includes charity, both giving volunteer programs in the community and the engagement with the community, how engaged are they in their community, and others.

SAMI: 15:51

And then the last one is diversity. They evaluate 11 items. One is the company's policy with regard to diversity as they disclose their policy, what is their policy, board diversity, what is the actual diversity on the board. Another element that they evaluate is contracts, how many contracts that are awarded to women and minority and things like that. So these are the five areas that they evaluate the company, and then overall CSR score. Then based on each one of these five, they have a score for it in that KLD database, STAT database, and then there is an overall CSR score. We use all of these six as measures of the nonfinancial corporate performance.

CROFT: 16:52

OK. And the same question for financial performance, which would seem to be a bit more straightforward and obvious, but I know there's a lot of different ways to measure financial performance. So what did you look at and how did you measure it?

PARVEEN: 17:09

Yeah, Jack, you are right. Financial performance is something that is very common. It is used as an outcome measure in a lot of research which occurs in the business schools across the country. So certainly, one of the strengths of this study is that we have nonfinancial and financial measures both. So we try to provide a very holistic perspective with the same data with regard to the impact of females on the board. To specifically answer your question, we try to divide the financial performance into buckets. And one of the buckets is the accounting variables we talk about. And the key variable that we talk about there is the return on equity, which is a very common measure.

PARVEEN: 18:06

It is the net income divided by the outstanding shareholders' equity. And that tells you how much one dollar invested in the equity is yielding and whether the needle is moving on that or not as a result of T+3, T+5 time frame after the induction of the females on the company's board of directors. Then the other bucket within the financial category we have, we kind of group them under the market measures. And a very common measure we start with is called Tobin's Q. It's an established matrix in the governance literature as an outcome variable. And it is essentially the ratio of the market value of a company's shares to the book value of the company's shares.

PARVEEN: 19:03 In other words, it is the market capitalization of the company divided by the shareholders' equity or the common stock in order to find that particular ratio. Because the real formula with regard to Tobin's Q is a bit more complicated and it's difficult to implement. So this is a proxy of the Tobin's Q that is a generally accepted variable in the accounting and finance and even or behavior literature. The two other variables that we throw in the market measures are cumulative annual stock returns. It is basically the raw return of an individual company that is accumulated over a year. And when we talk about the cumulative annual market-adjusted stock return, we are basically talking about the same variable, but we are adjusting it for the market in order to understand the abnormal performance by a firm. So those are the financial measures that we are focusing in our study.

CROFT: 20:16 All right. That brings us to the bottom line here for your study, which is-- and let's start again with the nonfinancial performance, but what were the key findings? Does increased gender diversity on corporate boards have a long-term impact on nonfinancial performance?

SAMI: 20:36 Yeah. As Parveen mentioned, we use T+3 and T+5. In the paper, we call it a three-year and a five-year lags performance when we analyze the nonfinancial measures. So notice that we have six measures: those five elements, and then the overall CSR score. And then when you consider the fact that we have two periods, three-year lag and five-year lag, so that means 12. And then when we do the regular ordinary lease squares analysis versus the two-stage lease squares analysis, then we have about 24 different tests. And our result shows that all of the components of the CSR have significant and positive relations with the percent of female directors on the board for both the three-year lag as well as the five-year lag. And out of all of those 24 different variations of analysis, there is one exception, the impact, which is very minimal. The impact on that is the impact of employee relation is not significant just for the five-year lag. That's the only part that is not significant. So overall, we conclude that inclusion of women on corporate boards improve company's CSR performance in the long run.

CROFT: 22:09 And does increased boardroom gender diversity have a similar long-term impact on financial performance?

PARVEEN: 22:18 Yes and no. So I will give you some of the specific findings with regard to the accounting measure, which is the return on equity. The impact of the female directors on the board is positive and significant for both the three and the five-year lags or the T+3 and T+5. For the market measures, the cumulative annual stock return and the market-adjusted stock return, we do not find any impact at all. And generally, one of the arguments that is presented at times in defense of the nonsignificant results is that perhaps it has something to do with the critical mass of the women on the board of directors because still the number or the proportion of females on the board of directors is relatively smaller as opposed to the larger board size. With regard to the presence of the female directors on the board, when we try to assess their impact through the Tobin's Q, we find that there is a positive impact on both three-year and a five-year lag. And we also use the two-stage least squares model in order to ferret out some of the confounds to revalidate that result. So we have sort of a mixed finding there when it comes to the financial performance.

CROFT: 24:12 Now one of the things I found interesting in your study is that you suggest that gender-diverse boards take more of a stakeholder view of the corporation than the traditional shareholder view. Can you talk a bit about the differences between those two views and what the possible implications are?

SAMI: 24:33 Stakeholders' view advocates maximization of social welfare. In other words, social welfare referring to those elements: environment, employee relation, community, diversity, and corporate governance. So a stakeholder's view advocates that one of the most important company's responsibilities are to maximize social welfare in these areas. Of course, in the process, they argue that if the company does this, then ultimately, it's going to help to improve their financial performance as well. But then the shareholders view on the other hand is predominantly concerned about maximizing shareholders wealth and nothing else. And that is maximizing corporate profit every year, stock prices, and the firm value. And they view the management's responsibility to do this year in, year out. So those are the two different views.

CROFT: 25:38 You also mentioned possible policy implications of the study. And what are the main takeaways for policymakers from your study that you would like to see them aware of?

PARVEEN: 25:52 So Jack, what happens is whenever you conduct any study as a business school professor, it is important to understand the public policy implications of your findings. And public policy implications consideration basically ties our study back to the initial motivation that we develop in our paper in order to study this topic. So I will not repeat in terms of what the motivation was as we already discussed. So policy implications, basically, are that whenever the regulators, for example, are planning or considering making rules, it is important for them to understand that, number one, it's a real issue. There is a demand for this kind of a demographic change across the corporate America, and as well as overseas, in terms of the female and underrepresented minority representation on the board.

PARVEEN: 27:04 So they need to be cognizant of that. Now, obviously, when policymakers are trying to set the rules, sometimes they end up mandating the requirements, and people have different views and opinions on that. I will quote you one thing. In the beginning, remember we talked about that California was the first state in order to come and mandate this kind of requirement. But as I was reading recently, just back in April itself, somebody had filed the lawsuit against that particular requirement and the court in California struck down that particular mandate. So whenever policymakers are going to establish quotas, I think they will run into the problems.

PARVEEN: 28:01 Similar kind of a problem has occurred in the European Union also because Germany in particular has been holding out on the 40% quota requirement. So I think one of the policy implications for the regulators across the world is to carefully craft the rules and also keep in mind the social justice aspect. Everything doesn't have to be sold in terms of the economics. Sometimes gender equality and having diverse board is a good thing to do because it is the right thing to do. So that's what I would think about when we talk about the policy implications.

SAMI: 28:49 The policy implication is that they should try to motivate rather than dictate, motivate the companies to increase the number of women on the corporate board.

PARVEEN: 29:00 — It's basically, I guess, the incentives work rather than have a stick approach and mandated requirements because depending upon what country you are in, you can run into resistance and then people get grounded in their positions, which can create a lot more problems and perhaps may do damage to the proprietary of the issue rather than help it. So it's very important for these regulators and policymakers to think it through carefully, how they want to achieve their ultimate noble goal.

CROFT: 29:40 — The final question that I usually wrap up with is, is there anything we haven't discussed that you think our listeners should know about the study that you did in the relationship between gender diversity on corporate boards and the firm's long term performance?

PARVEEN: 29:58 — I think what I would say with regard to that is that our listeners should certainly understand that this is an important issue. It is not going and by no means our study is going to be the last study because this is a very live issue. As the number of females and underrepresented minorities on the board of directors increase over the coming years, more and more research is needed in order to really establish once a critical mass has been reached in the boardrooms to see that do gender diverse or, in general, the diverse boards perform better than the more homogeneous boards. So this issue is here to stay.

SAMI: 30:52 — One clarification I just want to add is, as Parveen said before about the financial results, they are mixed. Particularly with regard to Tobin's Q, as we said before, we do two types of analysis. One ordinary least squares, the other one is two-stage least squares. And the results for Tobin's Q, which is a measure of the firm value, is opposite each other. For the OLS [ordinary least squares], we find positive effect of percent of female directors, but for the two-stage least squares, we find negative. So that's why the results are mixed.

CROFT: 31:32 — And that would also be something else that, as Parveen had just mentioned, I'm sure will be the subject of future study as well, so.

SAMI: 31:41 — That's right.

CROFT: 31:43 — I'd like to once again thank my guests, Parveen Gupta and Heibatollah Sami. Their research on boardroom gender diversity and long-term firm performance is an example of how faculty and students at Lehigh Business are advancing knowledge in the field of accounting and generating new ideas for education. This podcast is brought to you by IlLUminate, the Lehigh Business blog. To hear more podcasts featuring Lehigh Business thought leaders, please visit us at business.lehigh.edu/news. And don't forget to follow us on Twitter @LehighBusiness. This is Jack Croft, host of the IlLUminate podcast. Thanks for listening.