Gender board diversity: Further evidence on women in corporate governance

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ABSTRACT

Women are still underrepresented on corporate boards of directors. Although some surveys have documented gains in recent years, most inquiry into board gender diversity has focused on the largest publicly held firms (S&P 500, Fortune 500). Smaller firms have been largely ignored by researchers. The SEC has recently moved to encourage board diversity by issuing rules requiring public firms to disclose how they consider diversity in selecting director nominees. However, Butler (2013) has argued that the SEC itself is one of the barriers to women serving on boards, due to its rules regarding audit committee financial experts. This study extends prior research by comparing female representation on the boards of firms listed on the Russell Microcap Index to that of S&P 500 firms. It also examines the extent to which women serve on the audit committees of these firms and as financial experts. The results show smaller firms lagging far behind their larger counterparts with respect to gender diversity. However, there was no evidence that gender diversity is hampered by the specialized skills and experiences required of a financial expert. Surprisingly, females are named to audit committees or as financial experts at approximately the same rates as for the board of directors as a whole. An examination of recent director appointments provided no evidence of smaller firms closing the board gender diversity gap.

Keywords: Gender Diversity, Boards of Directors, Audit Committees, Financial Experts

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INTRODUCTION

The lack of gender diversity in the upper management and boardrooms of U.S. corporations has been often observed (e.g., Bilimoria & Piderit, 1994; Campbell & Minguez-Vera, 2008). Daily and Dalton (2003) memorably summarize the issue:

> Advocates of the status quo defend the relative lack of diversity on corporate boards as a function of too few women having the requisite qualities and experiences. Careful consideration of these criteria, however, reveals that male board members often fail to meet these criteria as well. Placing unduly restrictive criteria on the search for female board members becomes a self-fulfilling prophecy, a hunt for the mythical unicorn.
>
> Unlike the unicorn, the female director does exist, although she is a relatively rare species.

The issue has been of increasing relevance as evidence mounts of the advantages of a gender diverse board of directors. A recent report on the issue by EY (2013, p. 7) noted:

> Boards need to be prepared to discuss their composition with shareholders. Board diversity has become a priority for many investors. These investors intend to engage companies that do not have women on their boards through dialogue, letter writing and shareholder proposals.
>
> Boards that lack a breadth of diversity – across gender, ethnicity, age, geography and experience — and that are not challenging their composition and effectively conducting board assessment and development strategies — may risk becoming under-performing boards. They may lack the diversity and dynamism required to compete in today's global markets. Addressing gender inequality in the boardroom is one part of the solution.

The importance of diversity in corporate governance was further underscored by the Securities and Exchange Commission (SEC), which now requires firms to describe their process for evaluating director nominees. As part of that disclosure, Item 407(c)(2)(vi) of Regulation S-K requires firms to explicitly describe how they ". . . consider diversity in identifying nominees for director."

However, some have argued that the SEC is sending mixed signals about the issue. The Sarbanes-Oxley Act of 2002 (SOX) mandated that the SEC require companies to disclose whether their audit committees included a "financial expert." In implementing the SOX mandate, the SEC specified the skills and experiences that would qualify one to be considered a financial expert. Butler (2013) holds that the SEC's rule has the effect of discouraging females from being named to this important board committee.

Most research into board gender diversity has focused only on the large publicly traded firms. For example, the annual Catalyst census of women directors examines Fortune 500 companies (Catalyst 2013). EY's annual report on the issue deals with S&P 1500 firms (EY

2013). Left largely unexplored is whether women have made progress in joining the boards of smaller firms, which may be less scrutinized by analysts and public interest groups.

This study provides additional evidence about the current state of board gender diversity. It extends prior research in two ways. First, it examines the extent to which women have been able to join the boards of smaller corporations, providing a comparison of board gender diversity between large and small publicly held firms. Second, it provides evidence as to whether the SEC's audit committee financial expert requirements have adversely affected the ability of women to serve as experts or even on audit committees in general.

The remainder of the paper is divided into five sections. The first section briefly summarizes selected research into representation of women on boards of directors. The second section discusses the SEC's audit committee financial expert requirements. The study's methodology is discussed in the third section, followed by the presentation of the results. The paper closes with a summary and discussion of the findings.

GENDER DIVERSITY IN THE BOARDROOM

The scarcity of women serving as directors has been well established. Catalyst annually surveys the number of women on S&P 500 corporate boards. Their 2013 survey found that 16.9% of all board seats were held by females, a slight increase over the 16.6% found in the previous year (Catalyst 2013). The public accounting firm EY's survey of women directors found that 15% of the board of directors seats of S&P 1500 firms were held by women, an increase from the 11% observed in 2006 (EY 2013).

Both Catalyst and EY examined some of the largest corporations in the country, a focus common to most research in this field. For example, Daily, Certo and Dalton's (1999) investigation of long-term changes in female director participation employed a sample of Fortune 500 firms. Williams (2003) utilized Fortune 500 firms in an examination of female board members and corporate philanthropy. Peterson and Philpot (2007) also used a sample of Fortune 500 companies in their examination of committee memberships and the expertise of women board members. The Corporate Women Directors International (2008) used Fortune 500 firms to evaluate the relationship between female Chief Executive Officers and board gender diversity. More recently, Boulouta (2013) examined the link between corporate social responsibility and board gender diversity using a sample of S&P 500 companies.

One of the few studies to include smaller companies was Williams' (2005) examination of director attributes. She investigated the background and demographic characteristics of audit committee financial experts among both S&P 500 and smaller firms. She found that smaller companies had significantly fewer audit committee experts than did S&P 500 firms.

THE SEC'S RULES FOR FINANCIAL EXPERTS

The SEC has established the background and experiences that would allow one to be designated as a financial expert (SEC 2003). A person could become a financial expert by having:

- education and experience as a principal financial officer, principal accounting officer, controller, public accountant, or auditor, or experience in one or more positions that involve the performance of similar functions;

- experience actively supervising a principal financial officer, principal accounting officer, controller, public accountant, auditor, or person performing similar functions;
- experience overseeing or assessing the performance of companies or public accountants with respect to the preparation, auditing, or evaluation of financial statements; or
- other relevant experience. (above quoted from SEC rules, 2003)

When the SEC rules were first implemented, the overwhelming majority of audit committee financial experts were men. Williams (2005) found that only10.7% of audit committee members were female. Smaller firms had fewer female financial experts (4.6%) than did larger firms (11.9%). Her findings led Williams (2005, p. 265) to call for research into the "paucity of female experts." However, some progress in this area has been made in recent years. EY (2012) found that 16% of S&P 1500 audit committee members were women and that 15% of all audit committee financial experts were female.

However, Butler (2013) argues that the SEC's emphasis on financial, rather than accounting, expertise introduces gender bias. She notes (p. 4) that:

> (b)oth the title and qualifications highlight finance, which is a predominantly male dominated field. The gender bias of the Expert Regulation results from the disparity between the progress of women in the accounting and audit fields versus in the finance arena. . . . (T)hese Expert Regulation changes have a negative impact on the pool and current pipeline of women corporate board members, because the larger concentration of women professionals and entrants is in accounting and auditing as compared to finance.

METHODOLOGY

A random sample of 100 companies was drawn from the S&P 500 Index as of June 2013. To provide a basis for comparison, another random sample of 100 firms was drawn from firms comprising the Russell Microcap Index, also as of June 2013. The Russell Microcap Index is comprised of 2,000 of the smallest publicly held U.S. corporations.

Information about each sample firm's directors was collected from its most recent proxy statements available on the SEC's EDGAR database. Table 1 (Appendix) provides summary information about the corporate governance structures of the sample firms.

As Table 1 makes clear, the average S&P sample firm has both a larger board and audit committee than the average Microcap firm. It has also designated nearly twice as many audit committee financial experts. The greater number of positions available with larger firms would seem to provide more opportunity for women to serve in these capacities. Conversely, a single female director of a smaller firm will, in percentage terms, have a larger impact on board diversity than for a larger firm.

The Blau Index was then calculated for each firm's board of directors and audit committee. Often used in diversity research, the Blau Index provides a measure of the evenness of the distribution among gender categories (Campbell & Minguez-Vera, 2008). The Blau Index is computed as $1-\Sigma p_i^2$, where p_i is the percentage of board members of each gender. If a board is exclusively male or female, the Blau Index will be 0. If a board or committee has equal numbers of men and women, the resulting Blau Index will be .5. Because many firms only designate a single audit committee financial expert, the Blau Index was not computed at the financial expert level.

RESULTS

Table 2 (Appendix) presents data regarding the number and percentages of women on boards of directors. Of the sample's 1,844 directors, 274 (14.86%) were female. The percentage of women directors among the S&P 500 sample was 19.31%. However, among the Microcap firms in the sample, on 8.23% of directors were women. This percentage was significantly less than that of S&P 500 firms.

Only four of the hundred S&P 500 firms examined had no women serving on their boards, while 29 had more than two female directors. The Microcap firms presented a striking contrast, with over half (53) of the sample firms reporting no women on the board.

The overall sample Blau Index was .2096. However, this index of diversity was significantly greater among S&P 500 firms than among Microcap firms. While some have questioned the extent of gender diversity on corporate boards, Table 2 provides clear evidence that large firms are much more diverse than their smaller counterparts.

To investigate the extent to which women serve on corporate audit committees, directors of sample firms serving in that capacity were indentified. Data for audit committee gender diversity are presented in Table 3 (Appendix).

Surprisingly, the percentage of female audit committee members for the sample as a whole was higher (15.97%) than the percentage of female directors overall (14.86% from Table 2). That result was due to the S&P 500 firms in the sample, which reported 22.07% female audit committee members, compared with 19.31% of directors as a whole. In contrast, Microcap audit committees were actually slightly less gender diverse (8.06%) than their overall boards (8.23%). While only 29% of S&P sample firms had no women serving on their audit committees, 77% of Microcap firm audit committees were exclusively male. As was the case with the entire board of directors, the Blau Index of diversity was significantly lower for Microcap firms than for S&P 500 firms.

Table 4 (Appendix) presents the gender breakdown of the sample firms' audit committee financial experts. Although the absolute number of females designated as financial experts is less than the number of female audit committee members reported in Table 3, the smaller population of financial experts results in female percentages slightly higher than previously observed. As before, the percentage of female financial experts among Microcap firms is significantly less than for S&P 500 firms. Only 13 Microcap firms had women designated as audit committee financial experts.

Although technically serving one or three year terms, many corporate directors may hold places on their boards for decades. For example, one individual in the sample had served as director since 1958. To the extent that current, predominantly male, directors retain their board seats, it may be difficult for firms to significantly increase the gender diversity of their boards. Thus, the diversity percentages reported so far may not reflect aggressive efforts by firms to recruit women for open director positions.

To focus more closely on recent trends in director diversity, each director's date of appointment to the board was analyzed to identify those appointed since 2010. Table 5 (Appendix) provides information about the number of directors, audit committee members, and financial experts appointed during that period, as well as the number and percentage of female appointees. For purposes of comparison, the overall percentages of female representation from Table 2 are repeated.

The results in Table 5 provide a consistent picture. In recent years, there has been a slight increase in the percentage of women named to boards, to audit committees, or as financial experts. In all cases, the percentage of women named to fill positions exceeds the percentage for the sample as a whole. The differences are consistently positive, but small – when the percentage of females named before 2010 was compared to those named from 2010-2013, no differences were statistically significant.

Yet as Table 5 makes clear, even this result is primarily due to increased female representation among S&P 500 firms. Among Microcap firms, differences in percentages between recently named females and sample wide figures were so small as to be negligible. Recent trends do not indicate marked increases in gender diversity among the small firms in the sample and provide no evidence that they are closing the diversity gap between large and small companies.

SUMMARY AND CONCLUSIONS

This study investigates the issue of board gender diversity. It examines whether the SEC requirements to be designated as an audit committee financial expert provide additional barriers to women serving on boards of directors. The study also extends prior research by looking at diversity among smaller firms, rather than the large firms focused on by earlier studies. Several findings of interest were noted.

First is the difference observed between the Microcap and S&P 500 sample companies. In all cases, small firms had significantly fewer women named to their boards, serving on audit committees, or designated as financial experts than did large firms. While only 4% of sample S&P 500 firms has no women serving as directors, over half (53%) of Microcap firms had no females on their boards. Among smaller firms, exclusively male audit committees (77%) and designated financial experts (87%) were common. The disparity between large and small firms noted by Williams (2005) appears to have continued to the present day.

The second finding of interest is the observation that the SEC requirements to serve as an audit committee financial expert do not appear to be a barrier to females serving on audit committees or being named as financial experts. In most cases, the percentage of women serving in these capacities was actually slightly higher than for service on the board as a whole. It seems clear that women have the "qualities and experiences" needed for such roles.

Third, this study provides evidence that the gender diversity gap between larger and smaller firms is not narrowing. While S&P 500 firms are slightly increasing the rate at which recent board openings are filled with women, rates among Microcap firms appear stagnant in recent years. Since 2010, over 23% of open board positions with S&P 500 firms have been filled by women. Among smaller firms, the rate is only 9%.

Among larger firms, gender diversity appears to be continuing its pattern of small, steady increases. Among smaller firms, however, women directors are too often nonexistent, with no clear indicators of improvement. To slightly modify Daily and Dalton's (2003) memorable phrasing, women directors of small firms remain only slightly less rare than the unicorn.

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APPENDIX

Table 1
Sample Governance Characteristics

	Sample as a Whole	S&P 500 Firms	Microcap Firms
Board of Directors Size:			
Mean	9.23	11.03	7.42
Minimum	4	6	4
Maximum	17	17	12
Audit Committee Size:			
Mean	3.90	4.45	3.35
Minimum	1	3	1
Maximum	9	9	6
# of Financial Experts:			
Mean	2.08	2.73	1.43
Minimum	0	1	0
Maximum	9	9	4

Table 2
Board of Director Diversity

	Sample as a Whole		S&P 500 Firms		Microcap Firms	
	#	%	#	%	#	%
Female Directors	274	14.86%	213	19.31%	61	8.23%***
Male Directors	1,570	85.14%	890	80.69%	680	91.77%
Total	1,844	100.00%	1,103	100.00%	741	100.00%
Firms with no Female Directors	57	28.50%	4	4.00%	53	53.00%
Firms with one Female Director	57	28.50%	21	21.00%	36	36.00%
Firms with two Female Directors	55	27.50%	46	46.00%	9	9.00%
Firms with more than two Female Directors	31	15.50%	29	29.00%	2	2.00%
Total	200	100.00%	100	100.00%	100	100.00%
Mean Blau Index		.2096		.2927		.1264***

*** Difference significant at 0.01 level

Table 3
Audit Committee Diversity

	Sample as a Whole		S&P 500 Firms		Microcap Firms	
	#	%	#	%	#	%
Female Members	123	15.97%	96	22.07%	27	8.06%***
Male Members	647	84.03%	339	77.93%	308	91.94%
Total	770	100.00%	435	100.00%	335	100.00%
Firms with no Female Members	106	53.00%	29	29.00%	77	77.00%
Firms with one Female Member	70	35.00%	50	50.00%	20	20.00%
Firms with two Female Members	23	11.50%	20	20.00%	3	3.00%
Firms with more than two Female Members	1	0.50%	1	1.00%	0	0.00%
Total	200	100.00%	100	100.00%	100	100.00%
Mean Blau Index	.1869		.2760		.0977***	

*** Difference significant at 0.01 level

Table 4
Audit Committee Financial Expert Diversity

	Sample as a Whole		S&P 500 Firms		Microcap Firms	
	#	%	#	%	#	%
Female Experts	74	17.54%	59	22.35%	15	9.49%***
Male Experts	348	82.46%	205	77.65%	143	90.51%
Total	422	100.00%	264	100.00%	158	100.00%
Firms with no Female Experts	139	69.50%	52	52.00%	87	87.00%
Firms with one Female Expert	50	25.00%	39	39.00%	11	11.00%
Firms with two Female Experts	10	5.00%	8	8.00%	2	2.00%
Firms with more than two Female Experts	1	0.50%	1	1.00%	0	0.00%
Total	200	100.00%	100	100.00%	100	100.00%

*** Difference significant at 0.01 level

Table 5
Recent Trends

	Sample as a Whole	S&P 500 Firms	Microcap Firms
Board of Directors:			
2010-2013:			
Total Positions Filled	455	244	211
# Positions Filled by Women	76	57	19
% Positions Filled by Women	16.70%	23.36%	9.00%
% Female Directors in Total Sample	14.86%	19.31%	8.23%
Audit Committee:			
2010-2013:			
Total Positions Filled	184	93	91
# Positions Filled by Women	30	22	8
% Positions Filled by Women	16.30%	23.36%	8.79%
% Female Members in Total Sample	15.97%	22.07%	8.06%
Financial Experts:			
2010-2013:			
Total Positions Filled	94	53	41
# Positions Filled by Women	17	13	4
% Positions Filled by Women	18.09%	24.53%	9.76%
% Female Experts in Total Sample	17.54%	22.35%	9.49%