Boards with many female directors take as many risks as more male-dominated ones

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Although companies are increasingly under social and legislative pressures to increase female representation in their boardrooms, research is far from conclusive with regards to the economic consequence of the increase in boardroom gender diversity.

An often-cited notion is that female directors may discourage risky firm policies. For example, Christine Lagarde, Managing Director of the International Monetary Fund and former Finance Minister of France, famously stated in an interview that the recent financial crisis might not have been as severe if it had been 'Lehman Sisters' instead of 'Lehman Brothers'.

Existing theories suggest at least two ways that gender diversity in the boardroom can lead to firms making less risky policy choices. The first way is the "gender effect". This originates from many studies in economics and psychology that find women to have less appetite for risk than men. However, this effect may not be present in the boardroom setting. Renee Adams and Patricia Funks suggest from their research of Swedish directors that women who have broken through the 'glass ceiling' are not necessarily more risk-averse. The second way is the "diversity effect". The idea is that board deliberation by people from different backgrounds may lead to additional scrutiny and less extreme (i.e. less risky) outcomes. This also may not hold true. If more scrutiny means that it takes more time to achieve a consensus, board diversity may lead to higher firm risk. In addition, although women can be seen as coming from outside the "old boys" network, it is not clear whether they actually come from different education or socioeconomic backgrounds than existing male directors. Therefore, either theory does not give us a clear indication with regards to boardroom gender diversity and firm risk.

In a recent study, we use a large data set of S&P 1500 firms and investigate the relationship between the proportion of female directors and various measures of risk. We use both market-based measures (such as stock return volatility) and accounting-based measures (such as investment, gearing and diversification). The casual relation can be in two directions. The first one is that the change in gender diversity leads to the change in risk, and the second direction is that the change in risk leads to the change in gender diversity. We do not find any strong causal link for either of these explanations. Specifically, we do not find that a firm's risk diminishes after an increase in boardroom gender diversity. While we find that low-risk firms are more likely to appoint female directors, this increase in probability is too small to be economically meaningful. Thus, what we see in the data does not suggest a causal relation in any of the directions.

The main conclusion of our study is straightforward. A board with a higher proportion of female directors is no more or less risk-taking than a more male-dominated board. It appears that the data does not support the "business case" for boardroom gender diversity, at least from a risk perspective. However, does this mean that we should not aim for a higher gender diversity in the boardroom? We believe that, ultimately, the case for greater gender diversity on corporate boards rests on a sense of fairness rather than on pure economic considerations. The lack of strong empirical evidence on the relationship between gender diversity and risk, therefore, does not make gender diversity any more or less desirable.

More importantly, our results point to a gender bias in the director appointment process. We find that firms are less likely to appoint female directors if they already have a high proportion of female directors on their board. This suggests tokenism. Additionally, we find evidence consistent with a recruitment bias in favor of the status quo. Women are more likely to be appointed when a female director has recently departed the firm. Although we do not find that risk affects the gender of new directors, our results demonstrate that board appointments are not gender neutral. Discriminatory practices in the recruitment of directors should thus attract scrutiny by regulators.

Do our results support mandatory gender quotas? Although we find that the appointment process is not gender neutral, we do not find that the practice adversely affects firm outcomes. We also have to consider the possibility that firms' existing board compositions are already optimal given both internal and external competitive environments. Regulations such as gender quotas could cause a deviation from optimality and adversely impact firm value. Therefore, regulations around increased diversity disclosure and demands for more diversity by outside stakeholders may offer a more cautious route towards encouraging firms to bring more gender diversity to their boardrooms.

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Notes:

- *This article is based on the authors' paper Women on board: Does boardroom gender diversity affect firm risk?, Journal of Corporate Finance, Volume 36, February 2016, Pages 26–53.*
- *This post gives the views of its authors, not the position of LSE Business Review or the London School of Economics.*
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