In praise of diversity in Europe

European companies with diverse boards are more likely to perform strongly

BY DHR INTERNATIONAL EUROPEAN TEAM
It is now six years since Norway became the first country in Europe to legislate on board diversity, insisting that its listed companies should be at least 40 per cent composed of female directors. Since then, Belgium, Iceland, Italy, the Netherlands and Spain have all introduced their own versions of these rules, while the UK has told its largest companies it expects them to get to 25 per cent by the end of 2015, or face legislation. The European Union is still considering whether to impose quotas across all member states.

However, while regulation and legislation must be complied with, there is an even more compelling reason for European companies to embrace board diversity – and not just in terms of gender. DHR International’s research into European companies indicates a clear link between board diversity and performance. Put simply, where European companies have more diverse boards – more women and more directors from other countries – they tend to post better stock market performances.

Moreover, our research applies to executive directors. While the thrust of legislation has been to encompass executives and non-executives alike, DHR’s study suggests that by embracing diversity at an executive director level in particular, it is possible to boost performance. In other words, companies with more diversity at the top level of management do better.

DHR’s findings are supported by other studies of board membership. A survey published two years ago by Credit Suisse, for example, looked at 2,400 companies and concluded that investors would have done far better by putting their money into businesses with female board members (non-executives and executives) than those run only by men¹. A Thomson Reuters survey published last year found similar evidence of outperformance by companies with diverse boards – it also warned that companies with entirely male managements appeared to be more volatile².

As DHR’s research reveals, however, the issue of gender is just one question to address in the debate over the link between diversity and performance. Internationalisation of the board, particularly for companies with a global footprint, is also important. So too is having a board of manageable size.

1. Companies with greater board diversity are more likely to generate better stock market returns.

Companies that score well on board diversity had a tendency to outperform the stock market – as measured by the EuroFirst 100 Index - between 2009 and 2014, the period studied for this report. By contrast, those firms with lower board diversity scores tended to underperform over this period.

Frank Smeekes, managing director for Europe at DHR, thinks several factors may explain this outperformance. “Board diversity ensures that companies are getting fresh perspectives on the issues and opportunities they face. The tendency to ‘group think’ that you get when your directors are cut from the same cloth is dissipated with a diverse board, where you are more likely to find the robust challenge that non-executives in particular should be providing.”
Serge Lamielle, managing director of the Paris office at DHR, points to the importance of gender diversity in particular. “Men prefer the status quo while women are more likely to play devil’s advocate,” he says. “Also, men tend to overspend – women, who tend to control the household budget, bring that thinking to the workplace.”

Sue Rossiter, managing director and European practice lead for DHR International’s Global Life Sciences Practice, adds: “What you get with a diverse board is a business culture that is more open and forward thinking; the breadth of perspective and experience the board collectively enjoys enables it to make smarter decisions.”

2. Companies with larger boards have a tendency to underperform the market.
It is easier for companies to respond to pressure over board diversity by simply adding women and foreign nationals to their boards, rather than replacing existing board members with the new recruits. But this approach carries a clear danger: larger boards tend to underperform the market, DHR’s research reveals.

“Businesses need to confront this problem,” says Smeekes. “Large and unwieldy boards find it difficult to act decisively and it is more likely that executives have been appointed for the wrong reasons; they will also be more expensive to maintain.”

DHR’s research suggests that while it is a natural instinct for directors to cling to their positions, companies that want to reap the rewards of greater board diversity will aim to replace their incumbents rather than add to them—event if that has to be achieved gradually over time.

Those businesses that opt to avoid these difficult decisions may achieve the diversity they are looking for but fail to benefit from the general correlation between variety and outperformance. The dilution of the decision-making process that results from a large and complex board structure outweighs the advantages that diversity delivers.

3. Where companies have chosen to reduce the size of their boards over time, diversity has tended to fall.
Companies also need to be strong as they respond to the problems caused by having an over-large board. DHR’s research suggests that diversity tends to suffer when companies try to reduce the size of their boards—in other words, women and foreign nationals are disproportionately more likely to lose their directorships when a business cuts down board membership.

“The guys are fighting for their seats and because many of them have been in post for longer, they are deeply entrenched,” says Lamielle. “Just as women aren’t replacing the men when they join the board, they’re more likely than the men to lose their jobs if the board shrinks in size.”
The danger here is of a destructive cycle in which companies add women and foreign nationals to their boards in search of diversity gains, become frustrated when their overlarge boards fail to realize these gains, cut back on size by dropping the women and foreign nationals they appointed, and end up back where they started.

“We’ve seen evidence of this at a number of boards at leading European companies over the past decade,” adds Lamielle. “In too many cases, they have lost direction as a result.”

4. The type of diversity a company should prioritise will depend on its strategic objectives.

Are companies better served by prioritising the recruitment of female directors or should they look first for foreign nationals to join their boards? “Broadly speaking, I think you want your board to reflect the constituency of customers and shareholders that it works for,” says Rossiter. “That probably means ensuring gender diversity will be your first priority, but for many companies, hiring foreign nationals will be almost as important.”

Multi-national businesses in particular are likely to benefit from the perspective that directors from other countries can bring: a European company aiming to expand its activities in Asia, say, is likely to garner greater benefits from a director whose background is in the region than a company whose business is entirely domestic.

Equally, consumer-facing businesses may benefit from having an even greater number of women on the board than other types of company. Research suggests that, on average, women consumers make between 70 and 80 per cent of purchasing decisions, which makes a powerful case for greater female representation on the boards of companies seeking to sell to these customers.

5. Some sectors of industry have much more work to do to achieve greater diversity than others.

DHR’s research suggests that some industries and sectors have made much greater progress than others in promoting board diversity. For example, pharmaceuticals companies are more likely to score highly on DHR’s diversity index. Retailers generally score much less well – surprising given their exposure to consumer spending decisions.

However, it takes time and determination to change the make-up of a company – and board membership often reflects the wider dynamics of the organization. The pharmaceuticals sector, for instance, has long established graduate trainee programs that have encouraged applications from women – these candidates have subsequently progressed through the industry and are now approaching board level seniority. They represent a broader pool of talent from which to select directors than other sectors have access to.
Legislation – either national or international – may force many companies to move more quickly, particularly on gender diversity. But these businesses will need to work out how to accelerate their progress without making appointments of candidates who are not up to the jobs.

In conclusion, the evidence of DHR’s research is that when European companies are managed by a more diverse group of executive directors, they are more likely to generate greater rewards for their shareholders. Those businesses that have yet to embrace diversity should do so not because of pressure from legislators to inculcate greater equality – important though this undoubtedly is – but because their responsibility to shareholders requires it.

There will be bumps along the road towards diversity improvements. Many businesses will find it difficult to manage the process and making the right appointments will not always be straightforward. Nevertheless, the outperformance that diversity improvements can deliver are simply too valuable to be ignored.

What the directors say

Rob van den Bergh is the former CEO of multinational media company VNU who today holds a series of directorships at leading European businesses and not-for-profit groups.

“It’s not necessarily easy to definitively prove the link between better board diversity and improved performance, but my own experience is that the more diverse boards on which I’ve served or have lead have also been the ones that were strongest.

“It’s important not to start making generalisations – not all women are the same any more than men are, but there are certain qualities that women do often bring to the boardroom. They tend to be wiser, for example, taking more considered decisions for long-term good; they also tend to be less ego-driven.

“Equally, for companies with global aspirations, it seems obvious now that directors with knowledge and understanding of the markets in which you aspire to be a player will add value, but businesses haven’t thought like that.

“Diversity does bring its challenges. People with different backgrounds naturally arrive in the boardroom with different cultures and that needs to be managed with good governance. You need a skilled chairman in order to ensure that your board is cohesive and capable of reaching decisions together – the chairman has to bring it all together.

“It’s also a mistake to achieve diversity simply by appointing more and more people. It is very hard to be united and consensual when the numbers start rising, which totally undermines the point of the diversity.”

Marc Van Gelder is the former CEO of global medicines distributor Mediq, who now holds a number of board level positions at businesses across Europe.

“It is important not to take too narrow a view of diversity: gender and nationality are important of course but modern companies also need directors of different ages and industry backgrounds, for example.
“It's all about bringing different business cultures together. If you can do that, you will find the nature of the discussion changes completely – you get a far richer and more dynamic conversation and that is to the business’s advantage.

“I've seen this happen at companies where I've worked, which started out with very similar individuals on the board – then a foreign national, for example, has arrived for the first time and suddenly the outlook of the group is broader and less inward.

“Women also bring something different – very often they are better at relationships, for example, and just have a more instinctive understanding of what motivates people. They bring a whole different perspective to the table.

“Companies need to take care though – big boards definitely don't work well. Having too many directors will drive all the efficiency out of the decision making process and it becomes very difficult to reach a definitive consensus as each individual seeks to defend his or her vested interest and pursue their own agenda.”
Footnotes


Established in Chicago in 1989, DHR is one of the world’s largest retained executive search firms with more than fifty wholly-owned offices spanning the globe.

We operate as one firm and conduct search assignments at the Board Director, C-level and functional senior management levels. Our consultants are experienced professionals who are retained by Fortune 1000 as well as prominent venture firms and early-stage companies.

Since inception, DHR has been guided by its founding principles. Foremost, the consultants of DHR hold the highest of ethical standards, along with an unsurpassable level of personal service, an unmatched dedication to quality, and a unique ‘value-add’ approach. This philosophy and methodology are consistently demonstrated in DHR’s thorough and unparalleled researching capability, the full utilization of firm resources on every project, and the timeliness with which we complete our assignments.

In 2009, we entered the European market with a new concept. We position ourselves as a virtual pan-European organization truly focused on client needs and not restricted by individual country organizations. We have been building our presence through a Centers of Excellence concept and today are able to work across 20+ countries in Europe speaking eight languages. With a team of proven Senior Consultants and excellent Research Associates recruited from the leading brands we are able to implement a “Best Team” approach.

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