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Opinion

Companies in Emerging Markets are Getting on Board with Board Diversity

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For any investor who has initiated a conversation about a company gender diversity, particularly in the boardroom, does any of this sound familiar? "We have looked, but there are no qualified and experienced women available in our industry." Or, "We have asked women to join in the past, and they were not interested." Or, "We're working on it (or: There aren't any vacancies right now). Ask us again next year." And even, "Our board is good as is. We don't think we need to make any changes at this time."

Cartica Management is an investor in public companies in emerging markets. We regularly engage with portfolio company leadership to encourage them to improve in areas that we believe are detracting from value. Often, our engagements are focused on environmental, social, and governance, or ESG, issues, and we almost always initiate conversations about lack of diversity on portfolio companies' boards.

Our anecdotal experience working with our portfolio of emerging market companies tracks generally with the reasons companies globally say they don't have a greater percentage of women on their boards. Indeed, in 2020, the percentage of board seats held by women among constituents of the MSCI ACWI index (representing 50 emerging market and advanced economy countries) increased only 0.6%

There has been a small amount of progress in emerging markets over the past year. The percentage of board seats held by women in companies included in the MSCI EM Index increased slightly from 12.1% to 13% of all seats, and the percentage of male-only boards dropped from 34.3% in 2019 to 31% in 2020.

Gender alpha

As an investor, we often wonder if the lack of diversity on a board should raise a red flag about whether a company is forward thinking and committed to hiring top talent. Is the board really doing all it can to ensure expert guidance and oversight? Or are members more focused on maintaining their positions, and seeing their old friends once a quarter?

It is a good sign when we see board members demonstrate that they will go beyond their bubble to find expertise that is different and additive for the company. A 2019 study of U.S. publicly listed companies found that the presence of a female board member may help moderate the overconfidence of male CEOs. The effect is reduced risk, reduced costs of M&A transactions, and improved corporate decision-making.

The same study also found that companies with female directors were less negatively-impacted by the 2008 financial crisis, possibly because they encouraged a different risk profile for the company beforehand.

Companies with more women on their boards are also more likely to take proactive climate action and risk-mitigation measures, like integrating climate change effects into their risk models and financing decisions and reducing environmental impact of packaging, in addition to other ESG issues, like employee benefits and governance transparency.

Companies with more women directors are also more likely to take action on ESG issues.

Some research has shown that having only one woman on a board doesn't do much to change corporate behavior. Researchers theorize that one woman may feel isolated and marginalized and may not have enough power to change group behavior. Those same researchers suggest that three women serving on a board provides a critical tipping point at which a board and a company truly benefit from women's skill sets and diversity of thought.

We believe there is likely much validity to that research, but we also know that to get to three, boards need to start with one, and companies may see new benefits even as they work toward a more equitable gender balance.

Regulating change

There is broad recognition that companies should appoint more women to boards. A number of countries in emerging markets have started to institute "comply or explain" regimes for public companies: a firm should appoint a certain number of women to its board, or publicly explain why it has not.

Turkey and Malaysia, for example, have requirements for public companies to report on diversity statistics and to explain low diversity metrics. The Hong Kong Stock Exchange requires IPO applicants with all-male boards to explain how and when gender diversity will be achieved after listing.

Only three emerging market countries require companies to appoint at least one woman to their board: India, Pakistan and the United Arab Emirates. India's Companies Act of 2013 requires all public companies to appoint at least one woman to the board. It is still early days, but it will be interesting to see over time whether quotas do much to change company culture beyond the bare minimum. Research found that 70% of women who were appointed after the law came into effect in 2013 were classified as independent (and not members of a controlling family); they were not as likely to sit on important committees as male independent board members, however.

Most Indian and Pakistani companies covered by their respective legislation have only one woman on the board.

Korea, which has one of the lowest diversity rates in the world – 4% – last year introduced regulation that by 2022, large publicly listed firms should not have single-gender boards. There are no penalties for non-compliance, so given the lack of teeth, it is doubtful we'll see much of a change.

To contextualize how emerging markets are performing relative to advanced economies, in Europe, a number of countries require women's representation on company boards be 30% or higher. Norway kicked off the trend in 2003 when it required a 40% quota.

In the U.S., however, California is the only state with a mandate for public companies to have at least one woman on the board. Its percentage requirements will escalate over time.

Industry nudge

Much of the high-profile industry-led action is being driven by powerful corporate figures in advanced economies. Proxy advisors ISS and Glass Lewis generally advise voting against the nominating committee chairs of all male boards. State Street and BlackRock both have proxy guidelines for companies to have one to two women directors.

Last year, Goldman Sachs announced that it would no longer take public companies that had no board member diversity and said that starting in 2021, the bank would require at least two diverse members, with a focus on women.

Nasdaq filed a proposal with the SEC in December that would allow it to adopt new listing rules requiring companies to have – or to explain why they don't have – at least two diverse directors, including one female and one person who identifies as an under-represented minority or as LGBTQ. If allowed, this could be a gamechanger: 75% of Nasdaq's 3,200 global companies currently don't meet the criteria.

Networks and training

Groups like the 30% Coalition, 30% Club, BoardAgender, the Forté Foundation, Women Corporate Directors, 50/50 Women on Boards, Board Diversity HK and many others are working to build networks and provide women with the resources to access board opportunities. Formal and informal groups that recommend qualified women to nominating committees are also growing, and global recruiting firms are also focused on diversifying the slates of candidates they present to board nominating committees.

There are also a number of groups that provide women board training short courses or workshops in hopes that it will build their credibility for a board seat. This is controversial, however, as many qualified women say that they have never heard of a man who had to get training before being considered qualified to join a board.

What may be more useful is pushing to change the conversation about who should be considered qualified for a board seat. When nominating committee members recognize that they don't actually need yet another person who already serves on many boards, their aperture widens. Companies that broaden their search to focus on skills and not titles, or which consider C-suite women who may not yet have board experience will have quite a bit of additional exposure to qualified candidates. They just have to decide to look – and investors should encourage them to start now.

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