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IMPACT ASSESSMENT ON COSTS AND BENEFITS OF IMPROVING THE GENDER BALANCE IN THE BOARDS OF COMPANIES LISTED ON STOCK EXCHANGES

Executive Summary

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COMMISSION STAFF WORKING DOCUMENT
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IMPACT ASSESSMENT ON COSTS AND BENEFITS OF IMPROVING THE GENDER BALANCE IN THE BOARDS OF COMPANIES LISTED ON STOCK EXCHANGES

Executive Summary

1. PROBLEM DEFINITION

Company boards in the EU are marked by persistent and manifest gender imbalances, as evidenced by the fact that only 13.7% of corporate seats are currently held by women. Only 15% of non-executive directors in the EU are women.

Evidence shows that although women not only possess the educational[1] and professional[2] credentials to participate in the highest economic decision-making bodies, but are also willing[3] and available[4] to do so, from the outset, they are at a systematic disadvantage compared to men in attaining top management positions. Women face barriers rooted in the conduct and business culture of companies when trying to realise their full professional potential. The current recruitment practices for board positions are characterised by a high degree of opaqueness contributing to these barriers, thereby undermining an optimal functioning of the labour market for top management positions throughout the EU.

Female under-representation in board rooms of publicly listed companies in the EU represents a missed opportunity to make full use of the EU's human capital, as the positive externalities associated with enhanced female participation in company boards, which are felt throughout the economy as a whole, are currently foregone.

First, gender imbalance in the boards of publicly listed companies in the EU constitutes a missed opportunity at company level. Numerous corporate governance indicators point to the benefits of more gender-diverse company boards. A lot of evidence shows that companies with more gender-diverse boards are more profitable, and that the differences are statistically significant, provided that the level of representation of women in boards reaches a sufficiently high level in order to influence the behavioural patterns in decision-making.

Second, the under-representation of women has negative spill-over effects on the wider economy. It contributes to the gender employment gap (GEG) in terms of the representation of male and female employees at the different levels of responsibility in companies, for

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1 Almost 60% of EU university graduates are women. See Eurostat, Tertiary students (ISCED 5-6) by field of education and sex [educ_enrl5], 2009.

2 Women account for around 45% of the people employed across the EU. See Eurostat, Employment by sex, age groups and nationality [lfsq_egan], 3rd quarter of 2011.

3 Studies show that 83% of mid-level career women have expressed a strong desire to move up the company ladder. See http://www.mckinsey.com/Client_Service/Organization/Latest_thinking/Unlocking_the_full_potential.

4 Contrary to the commonly articulated belief that there is a lack of qualified women to take up a corporate seat in an EU company board, a 2012 database established by European business schools demonstrates the suitability and availability of over 7000 'boardable' women for seats in boards of listed companies. See http://gallery.mailchimp.com/3ad8134be288a95831cc013aa/files/2012_5_Commissioner_Reding_Initiative.pdf.

example, in managerial positions below board level, but also in terms of the overall labour market participation of men and women. It then feeds into the gender pay gap (GPG): women across the EU still earn around 16% less than men on average, a differential that is even higher in publicly listed companies. In addition, lower rates of female labour force participation and pay mean a lower return on education for both individuals and the public sector, with associated consequences for the EU's gross domestic product (GDP).

Empowering women to take leadership positions and thereby fully exploiting human capital, is key for addressing the EU's demographic challenges, for competing successfully in a globalised economy and for ensuring a comparative advantage vis-à-vis third countries. It is a necessary means to reignite economic growth as laid out in the Europe 2020 Strategy. This view was also endorsed by the public consultation, which demonstrated a consensus across stakeholder groups that empowering women to take leadership positions is important for both company performance and economic growth. Although they acknowledge this need and the economic benefits of enhancing gender diversity in the workforce, markets fail to make improvements. This market failure can be explained by the tendency of groups with a very homogenous composition to maintain their composition due to an aversion to working with persons from different backgrounds or of different gender and a preference to associate with others from their own group.

The current lack of women in boardrooms generates a vicious circle which perpetuates the under-representation of women in decision-making. The current board composition affects the attitude of a company towards gender equality and negatively influences the readiness to appoint more female board members. The lack of female board members also implies a lack of adequate mentors, sponsors and role models that could facilitate a woman's career progression, thereby preparing females with high managerial potential for board membership.

Despite two Council Recommendations (1984 and 1996), several legislative and non-legislative initiatives at national level and numerous attempts at self-regulation, female representation in boards of publicly listed companies has only increased by slightly more than 5% from 2003, to 13.7% by 2012. It is expected to advance at roughly the same pace to reach 20.4% in 2020. There is broad consensus from stakeholders that action is needed to achieve faster progress.

Moreover, divergence or the absence of regulation at national level also poses barriers to the internal market by imposing divergent corporate governance requirements on European listed companies. These differences can lead to practical complications for listed companies operating across borders, as well as for candidates for board positions. The current opaqueness of the selection procedures and qualification criteria for board positions in most Member States represents an important barrier to more diversity of board members and negatively affects both board candidates' careers and their freedom of movement, as well as investor decisions.

2. SUBSIDIARITY AND PROPORTIONALITY

Gender equality is one of the EU's founding objectives, as reflected in its Treaties (Article 3(3) TEU) as well as in the Charter of Fundamental Rights (Article 23). Under Article 8 TFEU the Union in all its policies must aim to eliminate inequalities, and to promote equality, between women and men. The EU's right to act in issues of gender equality in employment and occupation follows from Article 157(3) TFEU.

The current growing discrepancies in female representation on boards of listed companies between Member States are explained by the fact that although Member States may adopt measures to counter the under-representation of women in economic decision-making, many do not show any willingness or face resistance to act at their own initiative. Therefore, imbalances across the Union can only be reduced through a common approach, and the potential for gender equality, competitiveness and growth can be better achieved through coordinated action at EU level rather than through national initiatives of varying scope, ambition and effectiveness. Only an EU-level measure can help make optimal use of the existing female talent pools. **An EU-level initiative in this area would therefore fully respect the principle of subsidiarity.**

There is only a rationale for taking EU action if it is indispensable to redress the continuing under-representation of women. The legislative measure will thus be temporary, thus underpinning its compliance with the principle of subsidiarity.

The **proposed action is in line with the principle of proportionality** as it would be limited to setting common objectives and principles. In the spirit of minimum harmonisation, Member States would be given sufficient freedom to determine how these common objectives should best be achieved taking into account national circumstances. Any binding EU measure would not interfere with the possibility for companies to appoint the most qualified board members. The measure would fully respect the requirements of the relevant positive action case law of the Court of Justice of the European Union (CJEU), the specific purpose of which is to ensure compliance with the principle of proportionality.

3. OBJECTIVES

The **general objectives** are to promote gender equality in economic decision-making and to make full use of the existing talent pool for more equal gender representation in company boards, thereby contributing to the Europe 2020 objectives. In line with the underlying components of the problem, two **specific objectives** can be defined: i) to reduce the barriers for women to access board positions and ii) to improve corporate governance and company performance. This would lead to an operational objective of introducing a common target for the representation of each sex in boards of listed companies to be achieved by 2020.

4. POLICY OPTIONS

Having identified the need for a minimum harmonisation of measures to improve gender diversity in company boards, the screening of policy options has taken into account the principles of subsidiarity and proportionality, as well as consistency with the EU Charter of Fundamental Rights ("Charter") and other Commission policies. This is reflected in both the limited scope and timeframe to which any possible initiative would be subject. It would therefore apply only to publicly listed companies, with the notable exception of SMEs. Listed companies are highly visible and of pivotal economic importance. Furthermore, the female representation on their boards is one of the lowest compared to the other categories analysed.

As a working assumption, the target set in the retained policy options is 40%. This lies between the "critical mass" minimum that has been found necessary to have a sustainable impact on board performance (30%) and full gender parity (50%). Setting the compliance period until 2020 would enable a harmonised effort to increase the number of women on company boards throughout the EU duly taking account of the different points of departure of different Member States.

4.1. Option 1: Status Quo

This policy option would involve no new action at EU level; simply a continuation of the current situation.

4.2. Option 2: Legally non-binding option

This option would take the form of a non-binding recommendation to Member States to take appropriate measures to achieve a representation of at least 40% of each gender in company boards by 2020, thereby targeting both executive and non-executive directors of publicly listed companies in the EU.

4.3. Option 3: Minimal legally binding option – objective set for non-executive board members only

The binding legislative option would introduce a quantified objective to reach at least 40% representation of each gender in company boards by 2020 only applicable to non-executive directors of publicly listed companies in the EU. This option would not cover SMEs and would be temporary in nature, as would the two following ones.

4.4. Option 4: Intermediate legally binding option – objective set for non-executive directors plus flexible objective for executive directors

In addition to the legislative option of a quantified target of 40% for non-executive directors, this option would introduce the obligation to set a flexible objective for executive directors. This would be determined by the publicly listed companies themselves in the light of their own specific circumstances**.**

4.5. Option 5: Maximal legally binding option – objectives set for both executive and non-executive directors

This option would introduce a quantified target of attaining gender diversity in company boards whereby the level of representation would have to be at least 40% for each sex by 2020 for both executive and non-executive directors of publicly listed companies in the EU.

5. Assessment of Impacts

5.1. Assessment of Option 1

If no further action is taken, slow progress can be predicted towards achieving both the general and specific objectives, as the **participation of women** in company boards is expected to reach only 20.84% by 2020. As a result, this policy option would have a negligible **social and fundamental rights' impact**, or for the latter even no impact as far as the EU-level is concerned, given that the Charter would not be applicable pursuant to its Article 51(1) to measures taken by Member States that do not implement Union law.

The impact on the **gender employment** gap would be very limited since men would still be more than four times as likely as women to occupy a board position, and more than twice as likely to be managers. The **gender pay gap**, which is the difference between female and male salaries in listed companies, would be 23.72%, whilst the average **return on education** would be 18.2% for individuals and 22.11% for the public sector. **Company performance** is expected to yield an average of 10.78% ROE for listed companies in the EU-27.

As the status quo would not imply any change in **investment** or **administrative burden**, the corresponding costs are estimated to be zero.

5.2. Assessment of Option 2

Due to its non-binding nature, this option is expected to only tip the balance in favour of a non-binding action only in the Member States where this issue is currently under debate. In the light of past experience, a recommendation is assumed to be limited in its effects. The **participation of women** in the boards of publicly listed companies is expected to reach 23.57% by 2020, a slight increase of 2.73 percentage points compared to option 1. It would have a fairly small impact on **social and fundamental rights**since the associated benefits of gender equality would only be reaped to a very small extent. Where the recommendation is be implemented and achieves its objective of increasing the proportion of women in company boards and thereby reduce gender gaps, it would positively contribute to the promotion of gender equality and the rights enshrined in Articles 15 (freedom to choose an occupation and right to engage in work) and 23 (equality between women and men) of the Charter. Inasmuch as action by Member States following a recommendation must be considered as implementing EU law within the meaning of Article 51(1) of the Charter, Member States would have to ensure that the negative impact on the rights enshrined in Articles 16 (freedom to conduct a business) and 17 (right to property) of the Charter are minimised as far as possible.

This option would have moderate positive **spill-over effects on the wider economy** in terms of reducing the gender employment gap and the gender pay gap and increasing the average return on education. Due to the slight increase in the number of female executive and non-executive directors, it is expected to have a moderate effect on the overall aspects of **corporate governance**. On the basis of a conservative estimate **company performance** in terms of ROE is projected to increase by 0.67% compared to the baseline, leading to an additional net benefit for listed companies of about €4 billion.

Investment costs would arise only for Member States that follow the recommendation and, in the case of non-binding national measures, only for companies that respond to these measures. On that basis, the total annual **investment costs** in the EU are estimated to be €3.7 million for 2017 – 2020 and €651800 for 2021 – 2030. The average annual **administrative burden** due to the obligation on all companies affected to report the gender composition of their boards would amount to €115000. Assuming that all Member States that take measures would also monitor progress, the total annual average for the costs of **monitoring** in the EU is estimated to be €93000.

5.3. Assessment of Option 3

Based on the assumption of full compliance with the target, this option would generate an increase in the **participation of women** in company boards to 32.58% by 2020, a tangible rise of 11.74 percentage points compared to Option 1. Due to the fact that female non-executive directors' presence would increase to 40%, this option would have a considerable impact on **social and fundamental rights' impact.** Accordingly, it would trigger much greater associated benefits of gender equality would be felt at an appropriate level. This option would have a clear beneficial impact on gender equality and the rights laid down in Articles 15 and 23 of the Charter. Although it would also represent a limitation on the rights set out in Articles 16 and 17 in that it would restrict their right to determine by whom the company is managed and supervised, there is still a safeguard since it leaves a sufficiently wide margin of choice for selecting the most qualified board members as the instrument would only affect the overall gender composition of the company board. Given that this option only covers non-executive members, it would be less of a limitation as this function does not entail day-to-day management tasks. If companies are not able to find an equally qualified female board member, they do not have to attain the target.

This option would have a positive **spill-over effect on the wider economy** in terms of reducing the gender employment gap and the gender pay gap and increasing the average return on education. It would have a significant positive impact on **corporate governance**, with notable effects on board dynamics. Furthermore, **company performance** would visibly benefit from the increase in female board members since this option implies considerably higher **net benefits** than Option 2, leading to an increase in the net income of listed companies of about €15.7 billion, under a conservative estimate. The average ROE is projected to increase by 2.61% compared to the baseline.

Making the most of the available talent pool, this option would require €16.6 million in total annual **investment costs** for 2017 – 2020 and €3 million for 2021 – 2030. In addition, this option would generate a total annual **administrative burden** of €124000 for company reporting, while Member States would incur annual costs of €100000 to **monitor** the progress made.

5.4. Assessment of Option 4

The impact of this option on non-executive directors would be the same as Option 3. As regards the flexible target for executive directors, it is assumed that each company would replace one male executive director by one female director (leaving the average board size unchanged). This would represent a significant increase in the **participation of women** to 34.11% by 2020 in executive boards, thereby nearly doubling the number of executive female board members and increasing the overall number by 13.27 percentage points compared to option 1. This is due to the fact that on top of a 40% target for non-executive directors, female presence among executive directors would increase to 14.44%. Similar to the envisaged impact of option 3, this option would also have a considerable impact on **social and fundamental rights**, as the associated benefits of gender equality would be the same. Going slightly beyond Option 3 as far as the fundamental rights' dimension is concerned, however, the minimal prescriptive provision, which would act as an incentive for companies to raise their share of female executive directors and thus bring more women into the highest management posts, could render the beneficial impact on the rights enshrined in Articles 15 and 23 of the Charter even more substantial. Option 4 would not increase the negative impact on the rights enshrined in Articles 16 and 17, as each company would be free to set its own objective and determine the extent of its ambition.

This option would have a significant positive **spill-over effect on the wider economy** in terms of the reducing the gender employment gap and the gender pay gap and increasing the average return on education. **Corporate governance** indicators would score significantly better under this option. **Company performance** would also significantly improve. The corresponding **net benefits** are estimated to increase further, generating an additional net income for listed companies of about €23.7 billion under a conservative estimate, as the average ROE is projected to increase by 2.92% compared to the baseline.

Under this option, the total annual **investment costs** for 2017 – 2020 are estimated to amount to €18.3 million and €3.5 million for 2021 – 2030. These investment costs are not negligible but they are very modest given the above benefits for companies, quite apart from the macroeconomic benefits. The **administrative burden** on companies and **monitoring costs** for Member States would be the same as under Option 3, at €124000 and €100000 respectively, given that Option 4 does not impose any additional requirements than Option 3.

5.5. Assessment of Option 5

Assuming full compliance, this option is bound to be the most effective in terms of increasing the **participation of women** in company boards. The share is expected to reach 40% by 2020 amongst both executive and non-executive directors (compared to Option 1, this increase of 19.16 percentage points at board level would entail an increase of 32.19 and 15.25 percentage points for executive and non-executive directors). This option would have a very high impact on **social and fundamental rights**, as the benefits associated with gender equality would take significant proportions. It would achieve the furthest-reaching and most sustainable change in management and business culture, achieving the strongest positive effects for the position of women on the labour market. Conversely, the limitation to the rights of Articles 16 and 17 of the Charter would be more significant if gender equality considerations were to limit the choice in appointing the executive member responsible for a company's day-to-day management and the most important business transactions. Nevertheless, this limitation does not appear to be disproportionate, especially given the importance of the intended aim of gender equality which is recognised both in the Charter and the Treaties. In addition, this limitation can be mitigated since companies would not have to meet the gender objective where equally qualified candidates of the under-represented sex cannot be found, for example, in sectors where female participation in the workforce and management is particularly low, and where executive positions require specific expertise and experience in that sector. Policy makers would have to consciously take into consideration the extent of the restrictions on shareholders' fundamental rights when choosing this option.

This option would have a very significant positive **spill-over effect on the wider economy** in terms of the reducing the gender employment gap and the gender pay gap and increasing the average return on education. The binding measures for both executive and non-executive board members would have a very significant positive impact on **corporate governance** and **company performance** could see an increase in the average ROE by 3.95% compared to the baseline. This would generate an increase in the net income of listed companies of about €23.7 billion, under a conservative estimate.

Under Option 5 it is expected that total annual **investment costs** in the EU for 2017-2020 would amount to €26.5 million, after which the cost would decrease to €5 million for 2021 – 2030. These investment costs are not negligible but they are rather modest in relation to the benefits at company level presented above, quite apart from the macroeconomic benefits. **Administrative burden** on companies and **monitoring costs** for Member States would be the same as in Options 3 and 4, at €124000 and €100000 per year, respectively.

6. Comparison of Options

All policy options are expected to address the main drivers of the problem and would help to reduce to different degrees or even to break the vicious circle that prevents women from participating in corporate boards. A comparison of the consequences of the various policy options finds that (i) binding measures are more effective in meeting the policy objectives than non-binding measures, (ii) measures that target both executive and non-executive board members are more effective than measures only targeting one group and (iii) binding measures will generate more societal and economic benefits than non-binding measures.

At the same time, binding measures would entail comparatively higher costs and administrative burdens, but they are still rather modest given the projected economic benefits. Furthermore, the degree of effectiveness of the various policy options is directly linked to the extent of interference with the rights of the companies and the shareholders as their owners. Compared to a non-binding measure with a tangible yet limited effect, a substantial increase of the impact in terms of the policy objectives would require an instrument with binding force, setting targets for the composition of company boards. While the consequences of all options on fundamental rights are justifiable and in line with the principle of proportionality in view of the legitimacy of the policy objectives and the in-built safeguards, those that establish quantified targets for executive board members, the persons directly responsible for the operative day-to-day management of a company, would produce the most beneficial effects but would also represent the most significant interference.

The choice of option will depend on whether the increased cost and greater degree of interference with fundamental rights of binding measures could be justified by their wider socio-economic benefits, or whether non-binding measures are to be preferred because, although they generate fewer significant socio-economic benefits, and are less effective in terms of meeting the policy objectives, they also entail fewer constraints on the exercise of fundamental rights. The views of stakeholders will be taken into careful consideration in choosing between the various options.

The administrative burden is expected to be minimal for all policy options, given that they would apply only to publicly listed companies which are expected to be able to use existing reporting mechanisms to provide the necessary information on their compliance to the Member States. During the preliminary screening exercise of policy options, the options likely to entail an administrative burden were discarded at an early stage.

7. Monitoring and evaluation arrangements

In a legally binding measure is taken at EU level (options 3-5), Member States would have to monitor whether listed companies comply with the targets and report to the Commission on the state of implementation at national level. The Commission would, in turn, monitor whether the legally binding instrument has been correctly transposed and implemented at national level. The Commission would then report to the European Parliament and the Council on the progress made at regular intervals. It is expected that a legally binding EU measure would be limited in time, meaning that it would be repealed after a number of years, if sufficient progress is made and a realistic prediction arises that the upward trend in the participation of women in economic decision-making positions could be sustained upon the discontinuation of the EU measure.