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A Nordic perspective on corporate board diversity

- Analysis of board diversity and its impact on corporate performance in the 500 largest companies in Denmark, Norway and Sweden
- No significant diversity effect of gender, age, and nationality on stock market performance or on ROA



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Abstract: In this report we analyze board diversity and its impact on corporate performance. We investigate the 500 largest companies from Denmark, Norway, and Sweden and find no significant diversity effect of gender, age, and nationality on stock market performance or on ROA. We conclude that if increased diversity along these lines is attractive, per se, or as a matter of political preference, it can be achieved without shareholder value destruction. However, if board size increases due to the recruitment of more director diversity there will be an indirect cost in terms of value destruction.		
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EXECUTIVE SUMMARY

In this report we analyze board diversity and its impact on corporate performance. We investigate the 500 largest companies from Denmark, Norway, and Sweden. This report reveals that Scandinavian boards are surprisingly homogenous in terms of gender and nationality, whereas the age distribution is more diverse. The low level of board diversity in terms of gender and nationality in the Scandinavian countries seems puzzling given the participation of women in the workforce and the internationalization of the work force of Nordic firms.

We find substantial differences in board diversity among the Scandinavian countries. Board members tend to be older and less diverse in Denmark than in the other two Scandinavian countries. High gender diversity in Norway and Sweden probably reflects political priorities (e.g. the Norwegian quota). However, the very low fraction of women on Danish boards seems puzzling given the general perception of a highly egalitarian nation.

Apart from the differences between the Scandinavian countries, board diversity in Scandinavia is influenced mainly by industry effects and company size. Contrary to a common popular myth, we must reject the notion that diversity is lacking because of a self-selecting “old boys” network. The number of board connections of the Chair (a closed network) and the average age (older) of the board do not influence board diversity.

This study finds that board diversity is not significantly related to company performance in 2005 (regarding stock market valuation and profitability). This is true for all of our diversity measures and for an overall diversity index. This suggests that increasing diversity of Nordic boards is no “quick fix” to enhance firm performance. However, we note that the greater board diversity of Scandinavian firms do not produce *lower* firm performance, which suggests that enhanced board diversity, as a deliberate choice or as forced by law, can be achieved without a negative effect on firm performance and shareholder return. But, in case it means an expansion of the size of the board, value destruction may follow.

We consider this project a first effort, and as such, the findings need to be presented and discussed in the broader international research community. This also implies that our research findings, at this stage, are premature as a basis for policy making. Further work is particularly needed on alternative methodological techniques as the result can be sensitive to model specification. We also see the need to address the effect of board diversity on a broader set of corporate governance mechanisms, such as ownership and incentive structures of the firm.

PREFACE

This research report is a first attempt to empirically address the effect of board diversity in a cross-Nordic setting. We started the project during the fall of 2005 and this first report should be seen as a point of departure for further research on this issue in a Nordic context. We acknowledge the support from Nordic Innovation Centre and our respective research institutions.

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A NORDIC PERSPECTIVE ON CORPORATE BOARD DIVERSITY

1. INTRODUCTION: WHY FOCUS ON BOARD DIVERSITY?

In the aftermath of the large corporate scandals during the beginning of this decade (such as Enron, Worldcom in the US and Parmalat, Ahold in Europe), a number of practitioners have called for more board diversity. In addition to improved monitoring via board independence, there are also arguments for greater diversity related to enhanced innovation capability, better global understanding, and better understanding of diverse customer needs (Daily and Dalton, 2003; Robinson and Dechant, 1997). Furthermore, public demand for more board diversity, both in the U.S. (e.g., TIAA-CREF, 1997) and in Europe, has become widespread during the last decade. Thus, TIAA-CREF, one of the largest pension funds in the U.S. and an opinion leader in corporate governance, argued nine years back that boards should be filled by “*qualified individuals who reflect diversity of experience, gender, race and age*”(TIAA-CREF, 1997).

Whereas the Conference Board (Brancato and Patterson, 1999) and other institutions emphasize that diversity should make sense from a shareholder point of view, others would emphasize that diversity is a goal in itself (e.g., Bilimoria and Huse, 1997). A fierce debate has emerged in the Nordic¹ countries concerning the pros and cons for increased gender diversity and about the potential role of politicians/regulators in achieving it. This makes the region particularly interesting for empirical testing of the effect of board diversity. Furthermore, the political implications vary extensively across the region. In Norway the equity argument has become law, and Norwegian public firms (The “ASA”-firms) are required to have a 40% minimum board representation (among shareholder appointed board members) from each gender by the end of 2006. If an individual company does not meet this requirement within due time forced deregistration of the firm will result. A similar law was proposed in Sweden, but the change of government in the fall of 2006 led to a withdrawal of the proposed law.

The empirical evidence on the performance effect of board gender diversity is mixed. For example, one U.S. study identifies a *negative* relationship between the percentage of female

¹ In this first report we focus on Denmark, Norway and Sweden - the Scandinavian countries - leaving Finland and Island outside the scope of it.

directors and accounting performance (Shrader, et al 1997), and another study finds for Norwegian firms a *negative* relationship between female board membership and market-to-book ratio (Bøhren and Strøm, 2006). However, other studies find *no* relationship (e.g., Zahra and Stanton, 1988) or a *positive* performance effect from such female board membership (e.g., Carter et al, 2003; Smith et al 2005). There are number of possible explanations for the inconclusive empirical results. First, the studies are conducted in different countries and at different points in time, and the effect of board diversity might be contingent on the timing and the legal/cultural context (which has only partly been addressed in the research design of past studies). Second, the effect of gender diversity might be a substitute for other aspects of board diversity, such as age and nationality diversity, which need to be part of the research design. Third, empirical testing of the performance effect of gender diversity is methodologically challenging.

In the current study we address these issues when assessing the effect of board diversity among the 500 largest firms in Scandinavia. In addition to exploring the magnitude of this diversity, the major objective of this study is to explore the *financial* implications of board diversity. This implies that we do not address the issue of *equity* and board diversity. Our motivation is not that financial performance is the only or even the most relevant measure, but rather that it is interesting in its own right to examine whether board diversity passes the market test (e.g. whether the financial markets encourage or punish board diversity). Thus even when greater diversity is advocated for moral or political reasons it is still interesting to inquire how it is perceived by the stock market. Another motivation is that more empirical evidence is needed. A shortcoming of past research is the dominance of research on strictly Anglo-American markets (i.e. countries with a “market-based” system of corporate governance that emphasize shareholder primacy). The greater “stakeholder” orientation of corporate governance in Nordic firms might suggest that corporate boards, and thus board diversity, play a different and more significant role in these countries. Moreover, most existing research has relied on simple regression models and thus implicitly relied on the assumption that board diversity is exogenous (valuable exceptions include Hermalin and Weisbach, 2000; and Carter et al., 2003). We acknowledge that board diversity may well be an endogenous variable that is influenced by economic factors and that our results should be interpreted in light of that.

As for our results, we find significant differences between the magnitude of diversity of corporate boards in Denmark, Norway, and Sweden. Board members of Danish firms are significantly older and less diverse than in the two other countries. We find no effect of gender, age,

and nationality diversity on the corporate performance of the companies in our study. We conclude that if increased gender diversity is attractive per se, or as a matter of political correctness, it can be achieved without shareholder value destruction. However, if the board size increases due the recruitment of a female member there may be an indirect cost in terms of a value decrease.

The report is organized as follows: In Section 2 we discuss the theory and current evidence in regards to costs and benefits of increased corporate board diversity. Section 3 presents data on board diversity of our Nordic firms, whereas Section 4 contains an analysis of differences between boards in the three countries. In Section 5, we analyze the impact of age, gender, and nationality diversity on corporate performance. Finally, in Section 6 we summarize our findings.

2. THEORY: HOW DOES DIVERSITY AFFECT PERFORMANCE?

Corporate governance concerns the legal, institutional, and cultural mechanisms that help owners, as well as other stakeholders, to exercise control over corporate insiders and management (e.g. Shleifer and Vishny, 1997; Peace and Osmond, 1999). The corporate governance literature emphasizes that good corporate governance is one that facilitate long-term value creation for owners and other major stakeholders. Such corporate governance needs to be an outcome from the “optimal” interaction between owners, managers, and the board. Whereas the corporate as well as the political world commonly expresses a belief in a positive relationship between diversity and performance, the corporate governance theory does not provide a strong theoretical case for promoting diversity (Carter et al, 2003).

In this report, we focus on the effectiveness of the *board*, and we do so in a Nordic context. We acknowledge that the issue of board diversity is only one of many relevant sub-issues in relation to the overall corporate governance subject of the firm. However, it is beyond the scope of this report to address this broader issue of corporate governance in Nordic firms. This is clearly a task for future research.

As a starting point for theorizing on the performance effect of board diversity, we consider potential costs and benefits of board diversity. As to the evidence for diversity of Nordic firms, a small number of board diversity related research papers have been presented during the last few years (e.g. Tacheva and Huse, 2006; Adams and Ferreira, 2004). One particularly noteworthy study

has been performed by Bøhren and Strøm (2006). They emphasize how board effectiveness is a product of incentive alignment (boards' ownership), information access (network), and decisiveness (board diversity). However, their study was limited to Norway and focused on older data (1989-2002), but with impressive data coverage for that time period. After 2002, we have witnessed an increased involvement from governments in Norway and Sweden to make firms, whether voluntarily or by law enforcement, recruit more female board members, which motivates a study on recent data in a Nordic context.

2.1 Benefits of diversity

Resource dependency theory addresses how a board might facilitate access to valuable resources. The emphasis is on a firm's ability to form links to secure access to critical resources, such as capital, customers, suppliers, or cooperative partners (Alexander *et al.*, 1993; Mintzberg, 1983; Pfeffer, 1981; Pfeffer and Salancik, 1978). Thus, resource dependence theory addresses the potential for synergy between managers and owners. Stiles (2001) specifically suggests that board diversity might boost access to critical resources, which should suggest a positive performance impact of diversity as it relates to age, gender, and nationality. For example, a more diverse board could benefit from a greater understanding of its customers (Carter *et al.*, 2003) or other key stakeholders. Increased diversity means more information sources to tap, but at the expense of lower decisiveness. Recent management research has highlighted that board diversity might enhance boards' task performance, such as the board roles of service/advise, monitoring, and resource access (Daily and Dalton, 2003). However, for gender diversity, Techeva and Huse (2006) failed to identify such an effect among Norwegian boards. In fact, they found a significant negative effect of female board membership on board tasks of service/advise and financial control. On the other hand, Adams and Ferreira (2004) found that female board membership increased overall board meeting attendance among U.S. boards.

Research on group performance provides insights that might be applicable to board issues. Hoffman and Maier (1961) suggest that group diversity would enhance the overall problem-solving capacity. This indicates that the best performing team (board) should have members that represent variation in terms of gender, age, and nationality. However, the conclusions from the empirical research on heterogeneity and performance are not clear (e.g. an overview given by Hambrick, 1994). For example, Distefano and Maznevski (2000) find that cross-cultural teams are more creative and generate additional and better alternative solutions, but the average performance is not

significantly higher for more cross-cultural teams. In fact, the performance variation is higher for teams with greater cultural diversity.

Agency theory addresses how board composition might help to align the interest of more or less absent owners (the typical share owner in Scandinavia) with that of powerful and sometime opportunistic executives (e.g. Eisenhardt, 1989; Fama and Jensen, 1983). In order to reduce the conflicts of interest between absent owners and insightful CEOs, agency theory suggests a number of indirect ways to alleviate agency costs. These remedies can take the form of smaller boards (Yermack, 1996), a higher degree of board independence (Rosenstein and Wyatt, 1990; Cotter & Shivdasani, 1997), board ownership (Schleifer and Vishny, 1997; Bøhren and Strøm, 2006), or CEO part-ownership (McConnell and Servaes, 1990). The CEO is a member of the board in only 1/3 of Norwegian firms whereas in Sweden such a membership is more of a rule than an exception.

An agency rationale for diversity is that board diversity may increase board independence, which is needed to reduce the potential problems of CEO-dominated boards (Mace, 1971). Specifically, the CEO may be less able to manipulate a more heterogeneous board. This issue is particularly important in small Nordic countries with a limited pool of board candidates, in which conflicts of interest can easily arise in connection with interlocking board membership (Oxelheim and Randøy, 2003). By increasing the independence of the board, through the inclusion of foreign board members, one should expect to see reduced CEO entrenchment. With many outside board members sitting on several boards, a number of companies may have been experiencing or even expecting conflicts of interest among their board members. This makes it more difficult to achieve a well-functioning *domestic* labor market for board members. In light of the above argument, we suggest that the inclusion of foreign board members signals that the power of the “old-boys” network is being eroded, which in turn will manifest itself in a growing inclination on the part of the board to emphasize truth and frankness in serving their shareholders.

2.2 Costs of diversity

Studies in social psychology have found that the level of group loyalty depends on the similarity of group members. Thus, board diversity may reduce teamwork effectiveness because of lower group loyalty. Athey, Avery, and Zemsky (2000) emphasize that mentoring is more likely to occur between similar individuals. Kanter (1977) proposed that trust is facilitated by similarity in top management teams. She emphasized that team member trust may be more advantageous when

environmental uncertainty is high (see also Adams and Ferreira, 2002), but more difficult to achieve. The implication could be that board diversity is more “costly” among high-tech firms and firms in transition, but also potentially more valuable.

Likewise the social choice literature has found higher costs of collective decision making when the decision-makers are heterogeneous (Arrow, 1951). Board diversity may necessitate longer, less efficient board meetings, the probability of ambiguities, misunderstandings and decision errors may increase, and conflicts of interest may be more likely to occur.

In addition to lowering the decisiveness of boards, increased diversity can also make boards less efficient and resolute in monitoring. Thus, the grandfather of agency theory, Michael Jensen (1993), argues that *“suggestions to model the board after a democratic political model in which various constituencies are represented are likely to make the process even weaker.”*

2.3 Balancing cost and benefits

An efficient board nomination committee may be expected to balance costs and benefits of diversity in order to include a suitable mix of new members that can provide valuable information, but maintain sufficient homogeneity for effective decision-making. This balance would depend on industry- and firm-specific conditions, such as information needs, efficient use of authority (willingness to accept hierarchies), performance-related pay, or board culture (Adams and Ferreira 2002). In general, if firms tend to adopt efficient board structures we would not expect to observe any significant relationship between board structure and economic performance. For example, if firms could increase their market value by nominating more diverse boards, they would tend to do so. Expectations concerning observable relationships between board diversity and a firm’s value must therefore rely on factors that could cause deviations from efficiency.

One such factor could be inertia based on prejudice. Sociological institutional theories suggest that organizations may, for long periods of time, operate according to myths or business recipes that are not founded on financial efficiency (Meyer and Rowan, 1977). If boards discriminate against certain groups based on pure prejudice or other grounds not motivated by economic performance, this implies possibilities for arbitrage since valuable human capital is not put to efficient use. *Ceteris Paribus*, firms that break the ice should therefore have an advantage, which could be reflected in higher expected returns.

Another important factor in this respect is possible conflicts of interest between organizational performance and board group goals (Jensen and Meckling, 1976; Peled, 1997).

Board diversity may make board work more complex, unsettle existing power structures, and weaken the bargaining power of the board vis-à-vis shareholders and other influential stakeholders. The incumbent board may therefore resist increasing diversity even in cases where this might improve organizational and financial performance.

Another potential explanation for the “lack of diversity” might be the lack of information on the effect of diversity. Whereas the concept of board diversity has been championed in the business literature, nomination committees have had to make the difficult choice of the specific kind of diversity that is being promoted (gender, age, educational background, nationality, immigrants, etc.). Given the uncertainty of their task, nomination committees might be reluctant to press forward with more board diversity.

3. THE DATA: BOARD DIVERSITY IN SCANDINAVIA

The data for this report is taken from the 459 largest publicly traded firms in Scandinavia, of which we have 154 firms from Denmark, 144 firms from Norway, and 161 firms from Sweden. In a univariate context we will present data in accordance with these numbers. Due to non-response on some of our variables, we only have complete observations from 100 firms from Denmark, 86 from Norway, and 157 from Sweden. Hence, in a multivariate context, we may sometimes have to base the calculation on 343 observations. We have found no systematic pattern for non-responding firms that may matter to the interpretation of our results.

In Table 1 we provide average figures for supervisory boards in the three Scandinavian countries of Denmark, Norway, and Sweden. For convenience we refer to the supervisory boards (“bestyrelser”) simply as “boards” while we refer to the management board (“direktionen”) as “the management”.

TABLE 1 – Descriptive measures of Scandinavian boards in 2005

Variable	N	Mean	Std. Dev	Min	Max
Average board size	416	6,9	2,19	2,0	15,0
Shareholder elected females, %	415	11,2	0,12	0,0	60,0
Employee elected females, %	415	3,3	0,06	0,0	33,0

Total female representation, %	416	14,5	0,14	0,0	60,0
Foreign board members, %	398	8,4	0,16	0,0	100,0
Anglo-American board members, %	398	2,5	0,09	0,0	66,7
Average board member age	362	53,9	4,81	40,0	68,0
Age diversity (% below 45 or above 65)	467	24,4	0,43	0,0	100,0
Age deviation	363	7,7	3,08	0,7	19,8
Average chair age	373	57,8	7,99	34,0	83,0
Chair tenure (years)	398	5,9	5,59	0,0	31,0
Average number of board positions held by the chair in other public companies	410	1,1	1,48	0,0	7,0
Average number of board positions held by the CEO in other public companies	412	0,3	0,82	0,0	7,0

The average Scandinavian board is relatively small with only 6.9 members on average. This figure includes both members elected by employees and by shareholders. The figure is relatively low compared to large, listed firms from the U.S. and other large countries, but it must be stressed that there is a natural association between board size and company size, and that Scandinavian publicly listed firms are small when compared to the larger U.S. firms (e.g. the S&P 500 or the Fortune 500).

According to previous research, small boards are believed to be conducive for efficiency in decision-making and economic performance (e.g. Yermack, 1996; also verified by Bøhren and Strøm, 2006). A team size of 5-8 members is believed to be relatively efficient in problem solving whereas larger groups tend to disagree more and develop factions. Smaller boards are likely to be more efficient at exercising control over management, which is perhaps the most important function of the board (particularly among large mature firms). However, other board functions connected with diversity, such as advising and promoting business relationships or other contacts with the business community, may be easier to carry out in larger boards. The variety competencies (law, finance, engineering etc.) and the diversity of background (international experience, gender, age etc.) may be higher in large boards with more members. In theory, large, diverse boards should be better at challenging received views and “group-think” at the top management level, while smaller boards may find it easier to produce consensus and make quick decisions. However, with regard to collective action problems (as discussed by Hoffman and Maier, 1961), it may be difficult for a large board to form an effective counterweight to the management team, and consequently the

positive potential of board diversity never materializes.

Let us now turn to various types of corporate board diversity.

3.1 Employee representation on boards

Early on, the Nordic countries did force increased diversity by introducing laws about employee representation in boards. In Norway, employees in firms with more than two hundred employees have the right to elect 1/3 of the directors. The other two countries' similar rules illustrate one way to increase the female representation on the board of Nordic firms. Employee representation adds both to the size and the diversity of boards. In addition to this direct effect, employee board members may also produce indirect effects on board composition. Shareholders may feel that the "social" functions of the board are already filled by employee representation, and employee representation may make them more reluctant to an increased size of the board. On the other hand, it may also be that employee representation fosters more acceptance of diversity among shareholder elected board members.

3.2 Female board members

In our 448 Scandinavian firms 14.5% of the board members are women, most of them (11.3%) elected by shareholders. Therefore, the ratio of female to male board members is roughly 1:7, which is of course a significant deviation from equality, or 1:1. This finding, which is in accordance with previous studies, is surprising given the progressive and equality-seeking self-image of the Scandinavian countries. In terms of corporate governance, inequality is a problem if it implies a biased selection of board members in which the most competent members are not elected.

3.3 Foreign board members

The fraction of foreign board members, 8.4%, is also relatively low, particularly given that most of the publicly listed firms in Scandinavia do most of their business internationally, and that a significant number of their employees are international. Despite the importance of the English speaking world to international business and finance, only 2.5% of the board members are Anglo-American. As will be seen in the next section, Norway stands out with 5% of the board members from Anglo-American countries. It should also be noted that the employee representation system, in which employee representatives are elected by the domestic employees only, discriminates against foreign board membership.

The potential advantages of foreign board membership are numerous. First, a larger stock of qualified candidates would be available for the board (i.e. with broader industry experience). Second, because of their different backgrounds, foreign members can add valuable and diverse expertise which domestic board members do not possess. Foreign board members can also help assure foreign minority investors that the company is managed professionally in their best interests (as suggested by Oxelheim and Randøy, 2003). However, there are, of course, counter-arguments. For example, foreign board members may be less informed about domestic affairs and therefore be less effective. Moreover, most Nordic board members possess considerable international business expertise. Finally, changing the board language to fit foreign board members may be costly and add to adjustment problems. It is therefore an empirical question whether the low fraction of international board members presents a problem in itself.

3.4 Age diversity

Our surveys show considerable age diversity among Scandinavian firms. The average Scandinavian board member in a listed firm was 53.9 years old, while the typical Chair was a few years older (57.8 years old). The age dispersion (standard deviation) was 7.7 indicating that the typical board member was in the span of 7.7 years older or younger than the average. Almost a quarter of the boards (24.4%) are younger than 45 or older than 65, on average. Given that solid business experience is believed to contribute to board members' competencies, it is not surprising that board members tend to be in their fifties.

Chairs will usually be older than ordinary board members as they often come into their position by being a promoted board member. The average board membership tenure for a Chair is 5.4 years, which is not surprisingly high, since board members realistically require a few years of experience to get to know the company. In some cases, the Chair has been in the same position for a very long time, up to a maximum tenure of 25 years, but the average figures do not seem alarming.

3.5 Board positions of CEO and Chair

Finally, the average number of board positions in other listed companies held by the Chair and the CEO are quite limited – 1.1 for the Chair and 0.3 for the CEO. The maximum number of positions is seven for both categories. Typically CEOs or Chairs have only one other board position. In other words, the formal ties between listed companies in Scandinavia tend to be quite weak. Bøhren and Strøm (2006) identified a positive performance effect from having well

connected board members, which might indicate that Scandinavian firms can benefit from more inter-connected boards.

Summing up, Scandinavian boards are surprisingly homogenous in terms of gender and nationality, whereas the age distribution seems reasonable. We do not find evidence of a strong “old boys’” network or of excessive inertia among the board chairs.

4. COMPARISONS BETWEEN THE SCANDINAVIAN COUNTRIES

In Table 2 we examine differences in board diversity between the Nordic countries and test for statistical differences between them. In all cases the differences are highly statistically significant, indicating that there are substantial differences in corporate governance between the Scandinavian countries.

TABLE 2 – Basic statistics on Scandinavian Boards, country by country, in 2005

Variable	Denmark	Norway	Sweden	F-test
Average board size	6,8	6,4	7,4	7.09***
Shareholder elected female board members, %	2,9	20,4	13,1	93.43***
Employee elected females, %	4,3	3,7	2,0	5.18***
Total female representation, %	7,2	24,2	15,1	59.24***
Foreign board members, %	6,5	12,8	7,4	5.34***
Anglo-American board members, %	1,6	5,0	1,7	4.87***
Average board member age	56,3	51,2	54,1	34.34***
Age deviation	6,7	7,8	8,3	8.69***
Average chair age	58,3	56,1	58,6	3.35**
Chair tenure (years)	5,9	4,6	6,7	3.77**
Average number of board positions held by the chair in other public companies	0,7	1,4	1,3	10.55***
Average number of board positions held by the CEO in other public companies	0,2	0,4	0,4	4.03**

*** = significant difference between countries at 0.1% level. ** = difference significant at 1% level.

Note: The number of observations as a basis for calculations of different statistics in the table varies for Denmark between 100 and 154, for Norway between 86 and 144, and for Sweden between 157 and 161.

In terms of board size, we find relatively small systematic differences between the three countries. Swedish boards are a little larger reflecting the larger size of the average publicly traded Swedish company.

As is found in the table above, gender diversity varies significantly. At the end of 2005, the fraction of shareholder elected female board members was around 20% in Norway, partly as a result of the gender quota imposed by the government. In Sweden it was considerably lower at 13.1%, and in Denmark as low as 2.9%. The mysteriously low figure for Denmark invites several corporate governance questions, one of which, for example, concerns the efficiency of the nomination processes for new board members.

Denmark is also in at the bottom in terms of foreign board membership with 6.5%, which is less than in Sweden (7.4%) but roughly only half of the Norwegian figure (12.8%). Since all three countries are highly internationalized, these country differences also invite further research. The low figure of foreign board membership is striking given the evidence that, in particular, Anglo-American board membership might lead to lower agency costs and higher firm value (Oxelheim and Randøy, 2003).

The age deviation is also lower in Denmark than in the other two Scandinavian countries. Moreover, the board members in Denmark are, on average, typically 5 years older than in Norway. The gender quota imposed in Norway is part of the explanation for the lower age of Norwegian board members as nomination committees have limited number of experienced female board members to choose from.

Board ties tend to be very similar in Norway and Sweden, but much weaker in Denmark. It is somewhat surprising, yet consistent with previous research, that Danish boards are less connected.

Altogether, we find substantial differences in board diversity among the Scandinavian countries. Particularly, board members tend to be older and less diverse in Denmark than in the other two Scandinavian countries.

4.1 Association of board diversity measures

In Tables 4.1-4.4 we examine associations between board diversity measures by means of correlation coefficients. We provide such coefficients and statistical significance for the

Scandinavian countries as a whole as well as for the individual countries.

One highly pertinent question is whether diversity or homogeneity is self-reinforcing. This would be the case if a greater tolerance for board diversity with regard to gender leads to greater tolerance for other kinds of diversity in terms of nationality or age. The same will be the case if greater homogeneity is self-reinforcing, for example if boards composed of men of the same age group and nationality tend to increase the likelihood that other board members will be similar. In both cases board diversity measures will co-vary.

However, Tables 4.1-4.4 provide no robust correlation between the percentage of females on boards, the percentage of foreign board members, and age dispersion. Hence, while there is some association between these variables in the Scandinavian countries as a whole, the correlations are not robust. We do not find the same correlations in the individual countries and therefore attribute most overall correlations to country differences. For example, we see no significant correlation between the percentage of female board members and the percentage of foreign board members in Sweden and Denmark. Apparently the decision to appoint a foreign board member is unrelated to gender, and greater diversity in terms of nationality does not necessarily lead to greater diversity in terms of gender.

In Norway, however, we find a negative correlation which can be interpreted as an indication of substitution or competition between different kinds of diversity. For example, companies with substantial government ownership may be more likely to appoint a greater fraction of women, whereas companies with more international ownership are more likely to appoint foreign board members. Similarly, gender diversity appears to be positively related to age diversity in Sweden, but not in Denmark and Norway. For the most part, therefore, the age profile and gender profiles are unrelated.

Neither is international diversity (measured by the percentage of foreigners on board) systematically related to gender diversity or age diversity. Age diversity tends to be negatively correlated to the average age of the board in Scandinavia as a whole, but especially in Denmark and Sweden. Since many boards have age limits, a higher average age will automatically tend to reduce age diversity. Age limits (an example of officially sanctioned discrimination) are of course questionable from a diversity viewpoint.

The correlation matrices also examine the direct association between board diversity and three possible drivers of diversity:

- Other positions held by the Chair (a test off network effects – e.g. “old boys” network).

- Average age of the board (are older boards more conservative?)
- Board size (is there more room for diversity in large boards?)

We find no support for either of these associations in terms of strong correlations. Board diversity turns out not to be correlated with Chair positions. This indicates that the density of the hypothetical “old boys” network does not necessarily lead to a preference for “the usual suspects”. However, we do find a weak tendency in this direction in Norway.

Although gender diversity is negatively correlated with average board age in Scandinavia as a whole, we do not find any indication that older boards are less likely to have female members in any of the three countries. Thus the overall correlation probably reflects a nation effect (Denmark has older boards and less gender diversity).

Finally, the prediction that large boards tend to be more diverse turns out to be relevant in Sweden, but not in Norway or Denmark. One likely explanation is that large Swedish boards actively seek greater diversity. If the board is expanded as a result of the voluntarily or involuntarily inclusion of a female board member, this can lead to negative performance effects due to increased board size.

TABLE 4.1 - Pearson Correlation Coefficients, all Scandinavian companies

Scandinavian countries as an aggregate						
	Board Elected Females	Foreign Board Members	Age Deviation.	Average age	Av. nr. of board positions held by chair	Board size
Board Elected Females	1,00000 415	0.00868 0.8631 397	0.12826 0.0146 362	-0.2071 <.0001 361	0.10227 0.0392 407	0.11878 0.0155 415
Foreign Board Members	0.00868 0.8631 397	1.00000 398	0.09335 0.0803 352	-0.1123 0.0355 351	0.02736 0.5901 390	0.03060 0.5428 398
Age Deviation.	0.12826 0.0146 362	0.09335 0.0803 352	1.00000 363	-0.1970 0.0002 361	-0.0115 0.8293 357	0.06161 0.2416 363
Average age	-0.2071 <.0001 361	-0.1123 0.0355 351	-0.1970 0.0002 361	1.00000 362	-0.0387 0.4657 357	0.11351 0.0308 362
Av. nr. of board positions held by chair	0.10227 0.0392 407	0.02736 0.5901 390	-0.0115 0.8293 357	-0.0387 0.4657 357	1.00000 410	0.14297 0.0038 408
Board size	0.11878 0.0155 415	0.03060 0.5428 398	0.06161 0.2416 363	0.11351 0.0308 362	0.14297 0.0038 408	1.00000 416

TABLE 4.2 - Pearson Correlation Coefficients, Denmark

Denmark						
	Board Elected Females	Foreign Board Members	Age Deviation	Average age	Av. nr. of board positions held by chair	Board size
Board Elected Females	1.00000 150	0.01697 0.8411 142	0.06056 0.5495 100	0.06402 0.5269 100	0.00930 0.9110 147	0.07423 0.3667 150
Foreign Board Members	0.01697 0.8411 142	1.00000 142	0.27278 0.0063 99	-0.1758 0.0817 99	0.04989 0.5597 139	-0.0191 0.8214 142
Age Deviation	0.06056 0.5495 100	0.27278 0.0063 99	1.00000 100	-0.2063 0.0394 100	-0.0419 0.6820 98	-0.0414 0.6826 100
Average age	0.06402 0.5269 100	-0.1758 0.0817 99	-0.2063 0.0394 100	1.00000 100	0.16975 0.0947 98	0.14658 0.1456 100
Av. nr. of board positions held by chair	0.00930 0.9110 147	0.04989 0.5597 139	-0.0419 0.6820 98	0.16975 0.0947 98	1.00000 149	0.02985 0.7197 147
Board size	0.07423 0.3667 150	-0.0191 0.8214 142	-0.0414 0.6826 100	0.14658 0.1456 100	0.02985 0.7197 147	1.00000 150

TABLE 4.3 - Pearson Correlation Coefficients, Norway

Norway						
	Board Elected Females	Foreign Board Members	Age Deviation	Average age	Av. nr. of board positions held by chair	Board size
Board Elected Females	1.00000 104	-0.2509 0.0147 94	-0.0834 0.4068 101	0.01570 0.8761 101	-0.1813 0.0669 103	0.07722 0.4359 104
Foreign Board Members	-0.2509 0.0147 94	1.00000 95	0.10645 0.3125 92	-0.0183 0.8629 92	0.15552 0.1344 94	-0.1179 0.2552 95
Age Deviation	-0.0834 0.4068 101	0.10645 0.3125 92	1.00000 102	0.12619 0.2086 101	-0.0367 0.7141 102	0.15142 0.1287 102
Average age	0.01570 0.8761 101	-0.0183 0.8629 92	0.12619 0.2086 101	1.00000 102	-0.0745 0.4567 102	-0.0398 0.6916 102
Av. nr. of board positions held by chair	-0.1813 0.0669 103	0.15552 0.1344 94	-0.0367 0.7141 102	-0.0745 0.4567 102	1.00000 104	0.17859 0.0697 104
Board size	0.07722 0.4359 104	-0.1179 0.2552 95	0.15142 0.1287 102	-0.0398 0.6916 102	0.17859 0.0697 104	1.00000 105

Sweden						
	Board Elected Females	Foreign Board Members	Age Deviation	Average age	Av. nr. of board positions held by chair	Board size
Board Elected Females	1.00000 161	-0.0215 0.7869 161	0.19536 0.0130 161	-0.0448 0.5737 160	0.07230 0.3682 157	0.31928 <.0001 161
Foreign Board Members	-0.0218 0.7869 161	1.00000 161	-0.0921 0.2455 161	0.01917 0.8099 160	-0.1217 0.1291 157	0.19761 0.0120 161
Age Deviation	0.19536 0.0130 161	-0.0921 0.2455 161	1.00000 161	-0.3676 <.0001 160	-0.0378 0.6384 157	0.07451 0.3476 161
Average age	-0.0448 0.5737 160	0.01917 0.8099 160	-0.3676 <.0001 160	1.00000 160	-0.0117 0.8847 157	0.09582 0.2281 160
Av. nr. of board positions held by chair	0.07230 0.3682 157	-0.1217 0.1291 157	-0.0378 0.6384 157	-0.0117 0.8847 157	1.00000 157	0.20491 0.0100 157
Board size	0.31928 <.0001 161	0.19761 0.0120 161	0.07451 0.3476 161	0.09582 0.2281 160	0.20491 0.0100 157	1.00000 161

TABLE 4.4 - Pearson Correlation Coefficients, Sweden

4.2 Determinants of board diversity

In Table 4.5 we examine the determinants of board diversity. As highlighted in the theory section, we specifically address the impact of diversity of age, gender and nationality.

Parameter	Estimate	Std. error	t-value	Pr > t	Pr > F
<i>Model 1:Dependent variable- Females</i>					
Board size	0,0040	0,0032	1,26	0,2080	0,2080
Sales 2004	0,0000	0,0000	1,81	0,0717	0,0717
Chair positions	-0,0029	0,0040	-0,73	0,4688	0,4688
Average age	-0,0001	0,0014	-0,09	0,9294	0,9294
Country D	-0,1061	0,0147	-7,20	<0,0001	<0,0001
Country N	0,0871	0,0150	5,80	<0,0001	<0,0001
Country S	0,0000	-	-	-	-
Industry	-	-	-	-	0,0009
<i>Model 2:Dependent variable - Foreigners</i>					
Board size	0,0021	0,0046	0,45	0,6495	0,6495
Sales 2004	0,0000	0,0000	1,98	0,0482	0,0482
Chair positions	-0,0013	0,0058	-0,22	0,8230	0,8230
Average age	-0,0011	0,0020	-0,56	0,5781	0,5781
Country D	-0,0099	0,0212	-0,47	0,6417	0,2135
Country N	0,0333	0,0220	1,52	0,1307	0,2135
Country S	0,0000	-	-	-	-
Industry	-	-	-	-	0,0115
<i>Model 3:Dependent variable- Age deviation</i>					
Board size	0,1272	0,0910	1,40	0,1635	0,1635
Sales 2004	-0,0001	0,0001	-1,21	0,2276	0,2276
Chair positions	-0,0929	0,1142	-0,81	0,4163	0,4162
Average age	-0,1115	0,0397	-2,80	0,0054	0,0054
Country D	-1,2878	0,4226	-3,05	0,0025	0,0069
Country N	-0,7481	0,4301	-1,74	0,0830	0,0069
Country S	0,0000	-	-	-	-
Industry	-	-	-	-	<0,0001
<i>Model 4:Dependent variable- diversity index</i>					
Board size	0,0083	0,0056	1,49	0,1369	0,1369
Sales 2004	0,0000	0,0000	2,14	0,0332	0,0332
Chair positions	-0,0036	0,0070	-0,52	0,6058	0,6058
Average age	-0,0047	0,0025	-1,88	0,0606	0,0606
Country D	-0,1509	0,0257	-5,88	<0,0001	<0,0001
Country N	0,1100	0,0268	4,11	<0,0001	<0,0001
Country S	0,0000	-	-	-	-

TABLE 4.5 – Determinants of board diversity (regression analysis)

In Table 4.5, Model 1, we find that gender diversity is influenced by country and industry effects as well as firm size. Predictably, we find a negative “Denmark effect” and a positive “Norway effect”, which partly reflects that firm size (sales) tends to have a positive effect on gender diversity of the board. This is not just because larger firms tend to have larger boards, as we control for board size. We conjecture that large firms are more sensitive to social and political concerns, including gender issues, and therefore consciously promote more gender diversity. Many other plausible factors, such as board size, average age of the board, or the number of other board positions held by the Chair, appear not to matter.

In Table 4.5, Model 2, we find that international diversity is basically only influenced by firm size (sales), whereas industry, country, and the above mentioned diversity drivers do not appear to matter significantly. The low international diversity of Danish boards appears to be driven mainly by a small-firm effect.

In Table 4.5, Model 3, we find that age diversity is influenced by average board age, industry, and country effects, but not by firm size (sales), board size, and Chair positions. Again we see that Danish boards are more homogenous than Norwegian or Swedish boards.

Finally, in Table 4.5, Model 4, we construct a diversity index (% shareholder elected female board members + % foreign board members + Age diversity % of mean age of the board) to analyze the determinants of overall variations in diversity. As before, we find that general board diversity is driven by firm size, industry, and country effects. In addition, average board age has a negative effect on diversity, but is most likely attributable to the above-mentioned effect on age diversity.

The positive “Norway effect” on board diversity is partly attributable to the deliberate policies to increase female board participation, but it is notable that Norwegian company boards are also more international than boards in other Scandinavian countries. The strongly negative “Denmark-effect” remains significant after controlling for firm size, industry, and other relevant variables. Hence, regarding board diversity, we have found significant cross-border difference in our Nordic sample.

5. BOARD DIVERSITY AND COMPANY PERFORMANCE

In Table 5 we examine the effect of board diversity on the stock market value (market to book) of companies. Stock market valuations may be said to represent investors’ best estimate of the future earnings of the company and may therefore be regarded as a market based performance measure. We control for firm size and industry, which both turn out to be

significant. The performance is lagged one year.

TABLE 5 – Board diversity and company performance (regression analysis)

Parameter	Estimate	Std. error	t-value	Pr > t	Pr > F
Board size	-6,5654	3,0234	-2,17	0,0308	0,0308
Sales 2004	0,0110	0,0017	6,54	<0,0001	<0,0001
Chair positions	-6,5667	3,8207	-1,72	0,0869	0,0869
Average age	-0,9210	1,3402	-0,69	0,4926	0,4926
Females	18,1265	59,8472	0,30	0,7622	0,7622
Foreigners	-57,0623	39,0301	-1,46	0,1450	0,1450
Age deviation	-0,4946	1,9079	-0,26	0,7957	0,7957
Country D	9,3326	15,3813	0,61	0,5446	0,5588
Country N	14,5525	15,7884	0,92	0,3575	0,5588
Country S	-	-	-	-	-
Industry	-	-	-	-	<0,0001

We find that diversity has no significant effect on stock market valuation, either positive or negative. Since the performance measures are not highly correlated, the same conclusion emerges when we examine the effects of the individual diversity measure one at a time. This indicates that greater diversity would neither enhance nor reduce company performance. This result is not surprising given the generally weak and often contradictory results from similar non-Nordic research (e.g. Carter et al, 2003 versus Shrader et al, 1997).

There are several possible interpretations of this result. One is that board composition does not usually matter much to company performance, but rather affects individual board task performance (as suggested by Tacheva and Huse 2006). Another is that the true effects of board diversity are difficult to establish because so many other factors also influence company performance. A third interpretation is that the shareholders of Scandinavian companies weigh the costs and benefits of board diversity, and as such has reached the “optimal” level of diversity. Clearly, if it were possible for Scandinavian companies to increase their performance just by increasing board diversity, they would have very strong incentives to do so.

Contrary to our expectations we find no significantly positive effect accruing to companies having recruited foreign board members. However, Byrd and Hickman (1992) make the distinction between three categories of board members: inside, affiliated outside, and independent outside directors. In this study we have not been able to categorize the

foreign directors in such groups. Moreover, for the company to benefit fully from recruiting a foreign board member, the member should not only be independent but also be recruited from a superior governance regime, such as the Anglo-American regime (see Oxelheim and Randøy, 2003). In this study, we have not been able to separate independent Anglo-American board members from other foreign members.

In contrast, board size and the Chair's number of other board positions appear to have a negative impact on company performance. The implication is that shareholders regard companies with smaller, less connected boards as having better future prospects. There may be understandable reasons why shareholders do not limit board size or chair board connections. For example, large boards may emerge as more or less unavoidable by-products of mergers and acquisitions, and the Chair may be reluctant to give up other board positions. Moreover, social conventions may restrict changes in board fee structures. In principle, large severance payments for retiring board members and higher pay for board Chairs should make it possible to compensate board members. But higher fees may be difficult to reconcile with an egalitarian Scandinavian board culture. As for other control variables, both industry and company size turn out to have a significant effect on market valuation.

The effects of board diversity on accounting profitability (ROA) are no different from the effects on stock market value (and therefore not reported here). We find no significant effects of any of our diversity variables after controlling for industry, country, and size effects. In a simple regression, there is a significant negative effect of gender diversity, but this appears to be attributable to the effects of other variables on gender diversity.

We reach the same result when we estimate models which regard diversity as endogenous, for example regarding the diversity index as a function of size and nation effects, while performance is regarded as a function of diversity, company size, and other board variables. Board diversity appears to have no significant effect on performance.

6. DISCUSSION AND CONCLUSION

This report reveals that Scandinavian boards are surprisingly homogenous in terms of gender and nationality, whereas the age distribution is more diverse. The low level of board diversity in terms of gender and nationality in the Scandinavian countries seems puzzling given the participation of women in the workforce and the internationalization of the work force of Nordic firms. It is particularly paradoxical that firm from these countries have lower level of board diversity than similar publicly traded firms in Anglo-American markets (e.g.

Burke and Mattis, 2005), especially given the strong political emphasis on diversity among Nordic countries.

Nevertheless, we find substantial differences in board diversity among the Scandinavian countries. Board members tend to be older and less diverse in Denmark than in the other two Scandinavian countries. High gender diversity in Norway and Sweden probably reflects political priorities (e.g. the Norwegian quota). However, the very low fraction of women on Danish boards seems puzzling given the general perception of a highly egalitarian nation.

Apart from the differences between the Scandinavian countries, board diversity in Scandinavia is influenced mainly by industry effects and company size. Contrary to a common popular myth, we must reject the notion that diversity is lacking because of a self-selecting “old boys” network. The number of board connections of the Chair (a closed network) and the average age (older) of the board do not influence board diversity.

Larger boards tend to be more diverse in Sweden than in Norway and Denmark. Age diversity appears to decrease with average age of board members, but we believe this to be attributable to more or less mandatory retirement ages. Given a fixed maximum age a higher average age will automatically reduce age diversity.

Board diversity is not significantly related to company performance in 2005 (regarding stock market valuation and profitability). This is true for all of our diversity measures and for an overall diversity index. This suggests that increasing diversity of Nordic boards is no “quick fix” to enhance firm performance. However, we note that the greater board diversity of Scandinavian firms do not produce *lower* firm performance, which suggests that enhanced board diversity, as a deliberate choice or as forced by law, can be achieved without a negative effect on firm performance and shareholder return. But, in case it means an expansion of the size of the board, value destruction may follow.

As with any research project there are a number of limitations to this research project. We consider this project a first effort, and as such, the findings need to be presented and discussed in the broader international research community. This also implies that our research findings, at this stage, are premature as a basis for policy making. Further work is particularly needed on alternative methodological techniques as the result can be sensitive to model specification. As discussed earlier, we also see the need to address the effect of board diversity on a broader set of corporate governance mechanisms, such as ownership and incentive structures of the firm.

Future research on board effectiveness in the Nordic countries should address the issue in a broader context of corporate governance effectiveness. International research, such as

Adams and Ferreira (2004), suggests that board diversity affects board behavior directly and then performance only indirectly. The role of nomination committees should also be considered in this context. Ruigrok et al (2006) find that nomination committee composition matters in the nomination of foreign and independent board members, but not on female directorship. Furthermore, board diversity impacts other corporate governance mechanism within the firm – such as the effectiveness of CEO pay incentives and board incentives. This is also in line with recent research in management (Tacheva and Huse, 2006), which emphasizes how board diversity has a moderating effect on board effectiveness. We can conclude that board diversity affects *how* boards work, and changes in board diversity demands a rethinking of the corporate governance applied by Nordic firms.

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Nordic Innovation Centre

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