

December 11, 2020

## Dear Clients and Colleagues:

Last week, Nasdaq filed a proposal with the United States (US) Securities and Exchange Commission (SEC) to adopt new listing regulations related to board diversity. Upon approval from the SEC, the new policy will require Nasdaq-listed companies (subject to certain exceptions) to have, or explain why they do not have, at least one director who self-identifies as a female and one director who self-identifies as a racial minority or LGBTQ+. In addition, all companies listed on Nasdaq will have to disclose statistics on the diversity of their board. Under the proposed timeline, companies will have one calendar year from the date of SEC approval for statistics disclosure and two years for compliance with board diversity requirements.

In its proposal, Nasdaq noted a heightened focus on the matter by various stakeholders and the benefits of increased diversity in the form of fresh perspectives, improved decision making, and enhanced internal controls. The exchange also referred to several studies that found a positive, statistically significant correlation between board diversity and financial performance. For instance, according to the 2014 study by Credit Suisse, companies with higher participation from women at the board level demonstrated higher returns, valuations and payout ratios<sup>1</sup>. In another study, MSCI found that US companies with at least three women on their board of directors experienced higher gains in return on equity (ROE) and earnings per share between 2011 and 2016, in comparison to companies that had no female directors<sup>2</sup>. According to Catalyst, between 2004 and 2008, the ROE of Fortune 500 companies with at least three women on their board was higher than companies with no female directors<sup>3</sup>. McKinsey found a positive, statistically significant correlation between company financial outperformance and board diversity in gender and ethnicity<sup>4</sup>.

Even with the abundance of research demonstrating a positive correlation between economic performance and board diversity, some studies provide inconclusive results. For instance, Pletzer et al. found no statistically significant correlation between board diversity and financial performance<sup>5</sup>.

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<sup>1</sup> <https://www.credit-suisse.com/about-us-news/en/articles/media-releases/42376-201409.html>

<sup>2</sup> [https://www.msci.com/www/research-paper/the-tipping-point-women-on/0538947986#:~:text=U.S.%20companies%20that%20began%20the,\(EPS\)%20of%2037%25.](https://www.msci.com/www/research-paper/the-tipping-point-women-on/0538947986#:~:text=U.S.%20companies%20that%20began%20the,(EPS)%20of%2037%25.)

<sup>3</sup> <https://www.catalyst.org/research/the-bottom-line-corporate-performance-and-womens-representation-on-boards-2004-2008/>

<sup>4</sup> <https://www.mckinsey.com/featured-insights/diversity-and-inclusion/diversity-wins-how-inclusion-matters>

<sup>5</sup> <https://journals.plos.org/plosone/article?id=10.1371/journal.pone.0130005>

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Similar conclusions were made by Post and Byron in 2014<sup>6</sup>. Despite the lack of clear consensus among studies, Nasdaq believes the new rules will strengthen investor confidence as it signifies that listed companies consider diversity when selecting directors. After running internal research, and interviewing leaders of different market participants, in addition to studying third-party research, Nasdaq concluded that an additional regulatory impetus is required for companies to embrace their boards' diversity. Due to the inconsistencies of the current disclosures, Nasdaq could not provide a specific number of listed companies affected by the proposal.

This is not the first initiative of its kind on US soil, although the impact is regarded as unprecedented due to Nasdaq's ability to impose rules for more than 3,300 companies listed on its exchange. In 2018, California passed a law requiring publicly-traded companies headquartered in the state to have at least one female on their board of directors. The policy received strong pushbacks and some claimed it was unconstitutional, as it considered only gender and not other factors, and that it sought to regulate companies incorporated in other states. Although no other state mandates a minimum number of female directors, at least 11 of them have enacted or are considering legislation related to disclosures about the board of directors' diversity. Companies also face pressure from institutional investors. BlackRock, the world's largest asset manager, with \$7.4 trillion in assets under management (AUM), calls for board diversity of its investees<sup>7</sup>. State Street Global Advisors, the world's third-largest asset manager, with over \$3 trillion in AUM, pressures companies to ensure board diversity<sup>8</sup>. Goldman Sachs, one of the most significant underwriters of initial public offerings in the US, announced it would not take a company public in the US and Europe unless it has a director who is either female or diverse<sup>9</sup>. In Canada, as of February 1, 2022, the Institutional Shareholder Services (ISS) expects all S&P/TSX Composite Index constituents to have a minimum 30% female directorship or a written gender diversity policy with a commitment to reach a minimum 30% female directorship over a reasonable period.

The importance of board diversity receives significant regulatory attention across the globe, with many countries aligning their regulatory environment accordingly. Table 1 provides a summary of regulatory requirements by country where such exist.

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<sup>6</sup> [https://www.researchgate.net/publication/268146570\\_Women\\_on\\_Boards\\_and\\_Firm\\_Financial\\_Performance\\_A\\_Meta-Analysis](https://www.researchgate.net/publication/268146570_Women_on_Boards_and_Firm_Financial_Performance_A_Meta-Analysis)

<sup>7</sup> <https://www.wsj.com/articles/blackrock-companies-should-have-at-least-two-female-directors-1517598407>

<sup>8</sup> <https://www.ssga.com/us/en/institutional/etfs/insights/diversity-strategy-goals-disclosure-our-expectations-for-public-companies>

<sup>9</sup> <https://www.bloomberg.com/news/articles/2020-01-24/goldman-rule-adds-to-death-knell-of-the-all-white-male-board>

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Table 1: Global mandates and voluntary quotas on board gender diversity

Market	Type	Requirement	Introduced	Due date
Belgium	Mandatory	33%	2011	2017
Denmark	Mandatory	Varied	2013	n/a
Finland	Comply or explain	At least one	2008	n/a
France	Mandatory	40%	2010	2016
Germany	Mandatory	30%	2015	2016
India	Mandatory	At least one	2013	2015
Israel	Mandatory	At least one	1999	n/a
Italy	Mandatory	33%	2011	2015
Luxembourg	Comply or explain	40%	2014	2019
Malaysia	Comply or explain	30%	2017	n/a
Netherlands	Comply or explain	30%	2013	2016
Norway	Mandatory	40%	2003	2008
Pakistan	Mandatory for new directors	At least one	2017	n/a
Portugal	Mandatory for new directors	20%/33.3%	2018/2020	n/a
Singapore	Voluntarily	20%	2017	2020
Sweden	Comply or explain	40%	2016	2020
Spain	Mandatory	40%	2007	2015
Turkey	Comply or explain	25%	2013	n/a
UAE	Mandatory	At least one	2012	n/a
UK	Voluntarily	33%	2019	2020

Source: MSCI Women on boards 2019 Progress Report

According to a Deloitte analysis of more than 8,600 companies from 49 countries, women held 16.9% of board seats in 2018, up from 15.0% in 2016<sup>10</sup>. As of October 2019, out of the 2,765 constituents of the MSCI ACWI Index, 20% of directors were female, up from 17.9% in 2018, and 17.3% in 2017<sup>11</sup>. According to the Organisation for Economic Co-operation and Development's (OECD) database, 25.5% of board members of the largest publicly-listed companies in OECD countries are women with an even lower representation in emerging economies (e.g., 10.6% in Russia, 11.4% in China, and

<sup>10</sup> Deloitte Global Center for Corporate Governance, "Women in the Boardroom: A Global Perspective, Sixth Edition," (2019).

<sup>11</sup> Olga Emelianova and Christina Milhomem, Women on Boards 2019 Progress Report (MSCI, December 2019).

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15.9% in India)<sup>12</sup>. The top 10 countries where progress towards gender parity on board of directors is the most advanced are Iceland (45.9% female share of seats on boards of the largest publicly-listed companies), France (45.2%), Norway (40.2%), New Zealand (38.2%), Sweden (37.5%), Italy (36.1%), Belgium (35.9%), Germany (35.6%), Finland (34.2%), and Netherlands (34.2%). In the US, women account for 26.1% of seats on boards of the largest publicly listed companies. However, as Morningstar research shows, diversity in small-cap boardrooms is well behind their larger peers, with the female directorship only approaching high teen levels<sup>13</sup>.

The ongoing pandemic has highlighted the significance of a more comprehensive set of viewpoints at the leadership level to navigate these challenging times successfully. Working from home demonstrated ways to balance work and family life. As more companies are making flexible working arrangements permanent even after the pandemic, this environment creates more opportunities for women at senior corporate levels.

At Global Alpha, we firmly believe that diversity brings new perspective, drives innovation, inspires creativity, and makes companies more competitive. After all, it is reasonable to expect the boards to reflect the companies' customer base and societies in which they operate. Global Alpha is a signatory to the United Nations Principles for Responsible Investment, a member of the Responsible Investment Association of Canada, and a signatory to the Canadian Investor Statement on Diversity & Inclusion. ESG integration is a fundamental component of our investment process, and board diversity is one of the corporate governance factors that we consider when making investment decisions. Our portfolios demonstrate superior female directorship levels in the small-cap space, with 21.2% for Global Alpha Global Small Cap Strategy and 22.3% for Global Alpha International Small Cap Strategy.

Have a good weekend.

The Global Alpha Team

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<sup>12</sup> <https://stats.oecd.org/index.aspx?queryid=54753>

<sup>13</sup> <https://www.morningstar.com/content/dam/marketing/shared/pdfs/Research/Corporate-Board-Gender-Diversity.pdf>

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