Female chair: moving away from shareholder primacy

Book or Report Section

Accepted Version

Female Chair: Moving Away from Shareholder Primacy

by

Dr Sadi Boğaç Kanadlı

sadi.kanadli@alumni.esade.edu

and

Prof. Nada Kakabadse

n.kakabadse@henley.ac.uk

Synonym: Gender and Values-Direction of Boards

Cross-reference: Women on Corporate Boards and Sustainable Development

Introduction

Recent global and regional corporate governance trends are once again turning the spotlight onto corporate boards. Corporate purpose, which is drawing increasing attention particularly in the European Union (EU), is one of those trends that puts pressure on boards to take immediate action in shifting from traditional shareholder primacy to stakeholder considerations (Russel and Reynolds Associates, 2020). In August 2019, 181 out of 188 member Chief Executive Officers (CEOs) of the US Business Roundtable signed an amended Statement on the Purpose of a Corporation, putting aside the traditional view that maximizing shareholder returns is the top priority. This was followed by a December announcement from the World Economic Forum updating their 2020 Davos Manifesto (last published in 1973) (Schwab, 2020), challenging companies to put stakeholders at the heart of a company's purpose. Additionally, an increasing number of institutional investors have started to look for indices to discover whether a shift from shareholder primacy is taking place at firms they consider investing in. To this end, the S&P 500 ESG (Enviroment, Social, Governance) Index and yearly reports have been introduced (S&P Global, 2020) to assess companies' ESG performance on a yearly basis (Stedman and Perrone, 2019). Gaining investors' trust that a stakeholder mindset is adopted during decision-making and, thus, will soon reflect on ESG measures and reports may not be an easy task for boards, simply because boards are mainly comprised of independent directors who are appointed for their loyalty to the shareholder primacy. Additionally, independent directors, who share similar backgrounds and professional experience, are unlikely to provide diversity in perspectives, experience, or values that would consider not only the economic but also the environmental and social impact of strategic decisions. This chapter reflects on this important corporate issue and, as a solution, suggests that the appointment of women directors could bring the stakeholder mindset to board decision-making. However, only when women directors can be influential in male-dominated boards will this transition really begin. Relatedly, the argument in this chapter is enriched by discussing whether and how a female chair can play the role of a transition agent and, hence, strengthen an early signal to the investors that the transition from shareholder primacy to stakeholder considerations is taking place.

Moving Away from Shareholder Primacy

Imagine you invest some amount of money in firm A. According to shareholder primacy, what you should expect is for returns on your investment to be maximized at the end of the investment period. To this end, as a shareholder of firm A you want to make sure that your agent, the CEO of firm A, make decisions that set maximizing shareholder returns as a priority. How do shareholders monitor CEOs' managerial decisions as well as actions? The board of directors! This is why, for decades, boards have been seen only as monitoring mechanisms or "watch dogs", fulfilling one main role, of control. After the corporate scandals of early this century, the spotlight has been turned on boards, raising questions over their ability to successfully fulfil their fiduciary duty of control. As a solution, it was suggested that boards be independent. That is, where almost all directors are expected to be outsiders, having no affiliation with the firm or the top management team. The idea was simple: with no social relationship attached, non-executive directors (NEDs), who have expertise and experience in management efficiency, might better monitor managerial decisions and actions. Where boards are successful in fulfilling this monitoring role, it is expected that a repetition of the previous decades' corporate scandals would be avoided and that they would contribute to maximizing shareholders' return, which is seen as the main purpose of a firm.

In sum, according to shareholder primacy, the corporate purpose is to maximize shareholders' returns and boards are the independent control mechanisms serving this purpose. This understanding has become so powerful that corporate influentials – such as institutional investors, international organizations, non-governmental organizations (NGOs) – have suggested board independence as best practice of corporate governance. Several national governments have imposed board independence and effective implementation of the control role as legal obligations. Education systems, theory and research on corporate governance were no exception to this spread of ideology (Goshal, 2005). Although academic jury continues to discuss the mixed findings on whether shareholder primacy leads to better financial outcomes, today this mindset seems to remain the dominant view in the corporate world.

However, in the last decade, role expectations of boards have started to change and this development, together with rising public sensitivity to environmental and social issues, have contributed to the expansion of the board's role. In addition to the control role, boards are expected to offer advice and counsel to top managers, and even participate in and contribute to strategic decision making. It is interesting to note that, from recent reports on boards, strategy has become a priority for boards (McKinsey, 2016). This increase in a board's role expectations can be explained by the changing circumstances in a firm's environment. Facing a rapidly changing, volatile, ambitious, and uncertain environment, corporate leaders might have recognized that boards are in fact key assets, rather than merely watchdogs, which should be utilized in the strategy process. Research has demonstrated boards' contribution to decisions in, for instance, strategic change, investment, organizational innovation and corporate social responsibility (CSR) activities (Rao and Tilt, 2016).

Why it is important to acknowledge this change in boards from being control mechanisms to strategic decision-making groups? Simply because this change has opened the way to hold boards, together with top management teams, responsible for strategic decisions that may not favor the greater number of stakeholders, or perhaps the environment and society. Accordingly, sitting at the apex of decision-making, boards have started to feel the pressure of moving away from shareholder primacy and the reconsideration of the corporate purpose. This pressure belongs to the public, scholars, journalists, activists such as Greta Thunberg and even institutional investors (see also Canadian government's Bill C-97). What does it mean to put the stakeholder mindset at the center of corporate purpose? Laurence Fink, the chair and CEO of BlackRock and one of the signatories to the new Business Roundtable Statement, explains stakeholder primacy in practice. According to Fink, among other things, a company should consider its role in the community, its management of its environmental impact, its efforts to create a diverse workforce, its ability to adapt to technological change and take advantage of new opportunities, its retraining programs for employees in an increasingly automated world and its efforts to help prepare workers for retirement. But these goals are not just goals in and of themselves; they have a larger purpose (Posner, 2018).

It is hardly in doubt that moving away from shareholder primacy toward the stakeholder mindset has become an important topic for boards and requires immediate actions. However, injecting a stakeholder mindset into board decision-making might not be an easy task for boards. The dominance of independent directors with a loyalty to shareholder primacy might not provide the diversity in perspectives that would reflect a stakeholder primacy. One immediate action corporate leaders might take would be the restructuring of their boardrooms by appointing new directors, particularly those who might bring along a variety in perspectives and experience as well as values that might add the stakeholder mindset to board's agenda. However, this variety might also bring along its unique challenges, which would affect board dynamics and, hence, board decision-making.

Increasing numerical representation of women directors on boards continues to be another hot topic in the corporate world. Whether to comply with the recent gender quota laws or avoid increasing pressure from business influentials, corporate leaders are appointing women directors to their boards. What is interesting is that, although unintentionally, newly appointed women directors might be an important step in bringing the stakeholder mindset into boardrooms. Next, the case for appointing women directors on boards is explained in detail.

Moving Away from Shareholder Primacy: Appointment of Women Directors

Several well-known theories (behavioral theory, upper echelons theory, information processing theory) support the idea that boards make strategic decisions which are nothing but a reflection of the directors' cognitive frames. Decision makers' cognitive frames are shaped by their educational background, functional background, professional experience, values and beliefs. Cognitive decision-making is divided into three phases. Scanning is the phase where a director collects information about the decision/problem at hand. For example, a director with a background in finance would most likely collect information about the financial aspects of a decision/problem. Second is the interpretation phase where the information collected is harnessed with knowledge and values to generate an individual perspective on the problem. Similarly, a director with expertise in finance would create decision alternatives related to the possible financial issues of the decision/problem at hand. In the last phase, choice, decision alternatives are discussed between directors to reach a consensus on a final decision. This last phase is considered as a negotiation between different power/shareholder groups represented by directors.

Acknowledging the dominance of independent directors on boards, it will hardly be a surprise to see that board decisions reflect shareholder primacy. Board independence refers to the degree to which a board is comprised of NEDs, who are not affiliated with the firm and/or management in any way. On the surface level, increasing board independence would result in replacing executive directors with NEDs. However, at the deeper level, this change has led boards to be dominated by male directors with skills, knowledge and experience in finance who mainly have a reputation in safeguarding shareholders' profit maximization. In this regard, while board attention would be most often directed at maximizing financial performance, other aspects which can not be directly related to economic efficiency would be greatly neglected. This predicament is actually at the core of rising pressures against boards.

What action could boards take immediately to disentangle the fortresses of shareholder primacy? One main answer would be "change the board composition". As a matter of fact, boards might have already taken that action by appointing women directors to their boards, either voluntarily or as a legal obligation. Women directors on boards might start the transition from shareholder primacy to stakeholder primacy. Women on boards has become a worldwide topic in the last decade. Several national governments (e.g. Norway, Spain, Italy) have adopted women quotas on boards, requiring, for example, 40% of board members to be selected from women candidates. Women directors are often different than their male counterparts in relation to educational background, functional background, professional experience as well as values (Groysberg and Bell, 2013). These differences generate important outcomes that might explain the rationale behind the argument that women directors might bring a stakeholder mindset to board decision-making.

Managers from marketing, sales, research, and product development backgrounds might be more often exposed to situations where stakeholder demands are in conflict. Theory and research emphasize that while a vast majority of male directors come from a business background, a vast majority of female directors come from banking, marketing, law, and public relations. Women directors are also more likely to report having strengths in marketing and sales (Hillman et al., 2002). In this regard, due to their different functional backgrounds to their male counterparts, women directors can be expected to be more open to paying attention to multiple, competing economic, environmental, and social attributes to make sense of ambiguous sustainability issues. It should be noted that instead of the key difference being their sex, it is the career path that female directors pursue in general that explains why they might be more likely to bring a stakeholder mindset to male-dominated independent boards.

Additionally, female directors might help elicit multiple viewpoints and cultivate deliberativeness in decision-making, creating an atmosphere of a stakeholder mindset in the board (Huse and Solberg, 2006). Previous studies support this. Female directors are more likely to value interdependence, benevolence and tolerance; they are more empathetic than men and thus are more likely to accept others' standpoints; and they are more likely to use a cooperative decision-making approach that results in a fair decision when competing interests are at stake (Bart and McQueen, 2013).

Indeed, research shows that gender diversity increases the likelihood of firms getting involved in CSR activities (e.g. Rao and Tilt, 2016). For example, some studies have found that women have stronger environmental attitudes and commitment to a green entrepreneurship program than males, suggesting that women entrepreneurs may be more engaged in green issues than male entrepreneurs. Other studies show that female directors influence different aspects of CSR, such as charitable giving, and higher levels of environmental CSR.

While changing board composition by appointing women directors can be a necessary step in moving away from shareholder primacy in board decision-making, it might not always be sufficient. It is mentioned before that in the last phase of decision-making different perspectives are discussed at board level to reach a consensus on a final decision choice. This implies that women directors' different perspectives, which most likely would reflect a stakeholder mindset, should be heard, taken seriously and valued during board discussions. Although it may sound unrealistic, several studies emphasize that women directors face social barriers in male-dominated boards where they are perceived as unequal members of a board and categorized as tokens, as well as outgroup members (Groysberg and Bell, 2013; Huse and Solberg, 2006). The result is that they fail to participate and contribute to board decision-making. Therefore, appointing women directors, even with certain backgrounds and experience, is no panacea for moving away from shareholder primacy; nor will investors necessarily perceive it as a positive signal toward stakeholder primacy.

Repositioning the Female Chair: The Agent of Transition

Compared to the US, it is a more common governance practice in continental Europe and the UK that the CEO and chairperson positions are separated. However, recent reports suggest that the separation of the roles of chair and CEO is increasingly seen as best practice in governance in the US. The chairperson is the leader of the board, responsible for setting the agenda, keeping board discussions on track, and managing board meetings in such a way that each director's knowledge and experience is utilized. In this regard, an efficient chairperson can be an agent of transition. That is, an efficient chairperson may facilitate women directors' participation and contribution to board discussions. This might be achieved through setting an agenda that would reflect women directors' voice in meetings, by asking for each female director's perspective during decision-making and by working against social barriers women directors might face in the boardroom (Kakabadse et al., 2015). Research supports the idea that an efficient chairperson can influence social interactions between directors, facilitating directors' contribution to board decision-making (Kanadlı et al., 2018).

This important role that would help women directors start the transition might be gender sensitive. That is, a female chair may differ from a male chair in her leadership style and reaction to social categorization processes in the boardroom. The leadership style of women directors is distinguished by their tendency to be more sympathetic, more receptive, more caring, and more cooperative (e.g., Kakabadse et al., 2015; Huse and Solberg, 2006). A female chair may be more open to and supportive of a stakeholder mindset compared to a male director. Additionally, coming from a similar career path, experiencing similar difficulties while climbing to the c-suite, a female chair can be more sensitive to the social barriers women directors may face in boardrooms and, thus, be prepared to effectively handle boardroom dynamics so that female board members can be heard and be able to positively contribute to boardroom meetings.. A female chair, for example, may act as a mentor to newly appointed women directors, facilitating their participation in board work as well as giving advice about how to shape social relationships in boardrooms particularly with male directors (Kakabasdse et al., 2015). As a result of such sympathy for women directors and being the leader of the board, a female chair may change the overall balance of power in favor of women directors. In turn, this may help women directors overcome the silencing effect of high power male counterparts and be influential in affecting critical decisions. Research that investigates whether and how women on boards send positive signals to investors on various initiatives supports this line of reasoning that points out the important role a female chair plays. Lucas's (2003) study hints that the visual of a female chair can relay positive information about women's fitness for board director positions, warding off gender status differences. All in all, a female chair can act as the agent of transition against shareholder primacy by facilitating women directors' contribution to board decision-making and strengthening the signal that change is on its way.

Conclusion

Boards are no longer viewed only as control mechanisms. Boards are actively participating and contributing to strategy process and, therefore, are held responsible for a shift against shareholder primacy, which defines the corporate purpose as the maximization of shareholders' return. However, it is not an easy task. The appointment of women directors with certain backgrounds and professional experience is an immediate action to bring the stakeholder mindset to board decision-making. It is crucial to acknowledge that this transition requires an effective board leadership.

Cross references:

Board Diversity
Corporate Governance,
Gender Policies on the Board of Directors and Firms Financial Performance
Impact of board diversity on CSR practices, Stakeholder Theory

References

Bart, C. and McQueen, G. 2013. Why women make better decisions. *International Journal of Business Governance and Ethics* 8: 93–99.

Ghoshal, S. 2005. Bad management theories are destroying good management practices. *Academy of Management Learning & Education* 4(1): 75–91.

Groysberg, B. and Bell, D. 2013. Dysfunction in the boardroom. *Harvard Business Review* 91: 89–97.

Hillman, A. J., Cannella, A. A., and Harris, I. C. 2002. Women and racial minorities in the boardroom: how do directors differ? *Journal of Management* 28(6): 747–763.

Huse, M. and Solberg, G. A. 2006. Gender-related boardroom dynamics: How Scandinavian women make and can make contributions on corporate boards. *Women in Management Review* 21(2): 113–130.

Kakabadse, N. K., Figueira, C., Nicolopoulou, K., Hong Yang, J., Kakabadse, A. P., and Ozbilgin, M. F. 2015. Gender diversity and board performance: Women's experiences and perspectives. *Human Resource Management* 54: 265–281.

Kanadlı, S. B., Torchia, M., and Gabaldon, P. 2018. Increasing women's contribution on board decision making: The importance of chairperson leadership efficacy and board openness. *European Management Journal* 36(1): 91–104.

Lucas, J. W. 2003. Status processes and the institutionalization of women as leaders. *American Sociological Review* 68: 464–480.

McKinsey 2016. The CEO guide to boards. McKinsey. https://www.mckinsey.com/featured-insights/leadership/the-ceo-guide-to-boards. Accessed 15 January 2021.

Posner, C. (2018). When theories collide: what happens when the shareholder preeminence theory meets the stakeholder theory? Cooley Pub Co. https://cooleypubco.com/2018/01/17/when-theories-collide-what-happens-when-the-shareholder-preeminence-theory-meets-the-stakeholder-theory/. Accessed 22 December 2020.

Rao, K. and Tilt, C. 2016. Board composition and corporate social responsibility: The role of diversity, gender, strategy and decision-making. *Journal of Business Ethics* 138(2): 327–347.

Russell Reynolds Associates 2020. Is Your Board Ready for What's Next? Russell Reynolds. https://www.russellreynolds.com/services/ceo-board-advisory-partners. Accessed 21 January 2021.

Schwab, K. 2020. Davos Manifesto 2020: The Universal Purpose of a Company in the Fourth Industrial Revolution. We Reform. https://www.weforum.org/agenda/2019/12/davos-manifesto-2020-the-universal-purpose-of-a-company-in-the-fourth-industrial-revolution/. Accessed 20 January 2021.

S&P Global 2020. The Sustainability Yearbook 2020. Goldfields. https://www.goldfields.com/pdf/sustainbility/awards-achievements/robecosam-yearbook-2020.pdf. Accessed 15 December 2020.

Steadman, R. and Perrone, D. 2019. The S&P 500® ESG Index: Integrating environmental, social, and governance values into the core. 2019 S&P Global. https://www.spglobal.com/_media/documents/the-sp-500-esg-index-integrating-esg-values-into-the-core.pdf. Accessed 21 January 2020.