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As California goes, so goes the nation? Board gender quotas and the legislation of non-economic values

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2021 Global Corporate Governance Colloquium
June 11, 2021

Prior literature: Gender quotas and firm value

- Ahern and Dittmar (2012, QJE):
  - Adoption of Norwegian quota is associated with sign. stock price declines.
  - Boards became younger and less experienced.
  - ⇒ Friction-based explanation: Limited pool of female candidates leads to a reduction in board quality and firm value.
- Eckbo, Nygaard, and Thorburn (2021, MS fc):
  - Quota-induced changes in market values of ASA-firms are insignificant.
  - ⇒ The pool of qualified female directors is large enough.
- Greene, Intintoli, and Kahle (2020, JCF) and Hwang, Shivdasani, and Simintzi (2021, WP):
  - Robust evidence of a negative market reaction to California's quota adoption announcement; evidence consistent with a friction-based explanation.
- Gertsberg, Mollerstrom, and Pagel (2021, WP)
  - Negative quota effect in CA is not due to frictions in the director labor market, but the replacement of the "wrong" male directors.

Our study: Findings and contribution

- Evidence of a robust negative announcement effect of California (CA) firms to the quota's adoption.
- We find large spillover effects to firms headquartered outside CA, in particular in states that followed CA's legislative lead in the past.
- Frictions can explain part of the negative announcement returns of CA firms, but not the spillover effects.
- We propose an alternative channel: Adoption of the quota signals willingness for future regulatory interventions targeting non-economic values.
- The negative stock market reaction to the quota's adoption is not entirely about women, but about anticipation of future regulatory interventions.

Anecdotal evidence: Policy uncertainty channel

- SEC commissioner Hester Peirce:
  - *"The focus of the California bill – women on boards – is one piece of a broader set of ideas encapsulated by the snappy acronym ESG."*
  - *"Directing companies to give priority to stakeholders rather than shareholders would lower the value of existing shares."*
  - *"Policymakers might be tempted to get this or that favored group included in the stakeholder definition. Opening such a wide door introduces uncertainty and political influence into corporate operations."*
  - *"As they say, nothing that happens in California, stays in California."*

Source: Peirce, H.M., 2018, My beef with stakeholders: Remarks at the 17th Annual SEC conference, *Center for Corporate Reporting and Governance*.

The California Senate Bill 826

- On September 30, 2018, CA became the first U.S. state to adopt a mandatory gender quota for listed firms headquartered in CA.
- By year-end 2019, companies had to have at least one female director.
- By year-end 2021, companies with five directors are required to have two women on the board, and companies with six or more directors are required to have three women on the board.
- The effectiveness of the law is still debated:
  - The statute is non-criminal with comparably weak penalties ((recurring) fines of $300,000 for each violation).
  - The law may be unconstitutional: It may violate the corporate internal affairs doctrine or the equal protection clause of the U.S. constitution (or both).

Sample selection

- Cross-section of Compustat firms with reporting date within one calendar year before September-end 2018.
- Drop:
  - financial and utility firms (SICs 6000-6999 and 4940-4949)
  - firms headquartered outside U.S. or without information on headquarter state
  - firms with negative book value of equity, with missing financial controls, without listing on NYSE, AMEX, or NASDAQ, and with only ADR listing
  - firms without director data in BoardEx
  - firms with insufficient data to run the event study

→ 2,454 firms; 458 CA firms, 1,996 non-CA firms

→ Industry- and size matched control sample of 780 non-CA firms.

Market reaction to quota's announcement

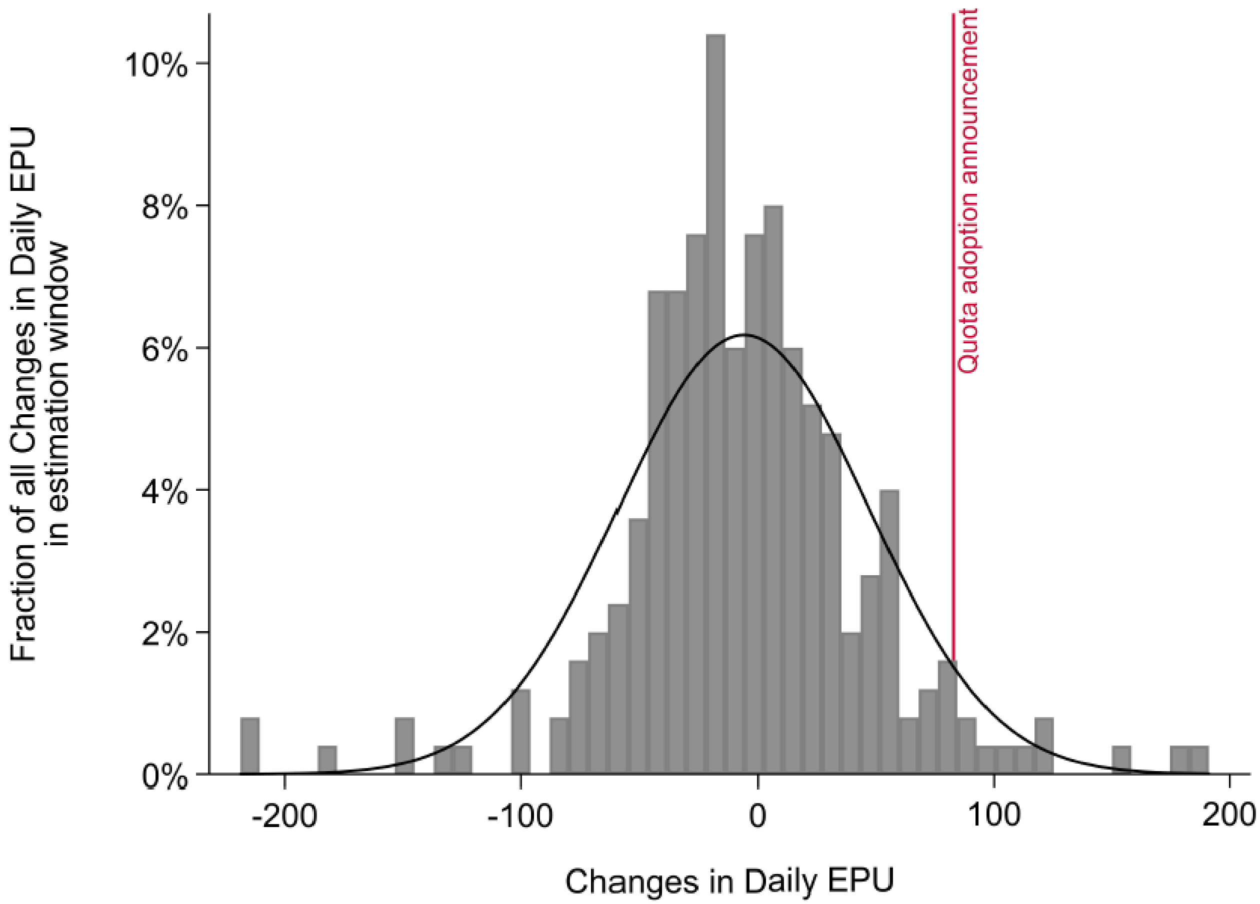
Dependent variable:	CAR(0,1)	CAR(-1,1)	CAR(-2,2)
	(1)	(2)	(3)
CA HQ (d)	-0.70**	-0.74**	-1.14***
	(0.27)	(0.33)	(0.41)
ln(Total assets)	0.09	0.14*	0.12
	(0.07)	(0.08)	(0.10)
ROA	-0.72	-0.41	-2.21**
	(0.53)	(0.66)	(0.89)
MTB	-0.03*	-0.03	-0.05
	(0.02)	(0.02)	(0.03)
Constant	-1.90***	-2.23***	-1.31*
	(0.50)	(0.58)	(0.69)
R^2	0.01	0.01	0.02
N	1,238	1,238	1,238

Firm-level measure of sensitivity to legislation

- Economic Policy Uncertainty (EPU) index of Baker, Bloom, and Davis (2016, QJE): Scaled number of newspaper articles containing the words
  - ‘uncertainty’ or ‘uncertain’,
  - ‘economic’ or ‘economy’,
  - one of the following policy terms: ‘congress’, ‘deficit’, ‘Federal Reserve’, ‘legislation’, ‘regulation’ or ‘white house’ (including variants).
- Procedure similar to Koijen, Philipson, and Uhlig (2016, Econometrica) and Akey and Lewellen (2017, WP).
- We estimate a market model augmented with the daily EPU change.
- We classify firms as policy sensitive, if the coefficient on change in EPU is significant: 138 (11.15%) of 1,238 sample firms are policy sensitive.

Firm-level measure of sensitivity to legislation

- The gender quota had a meaningful impact on investors' uncertainty regarding economic policies in the U.S.:



Impending legislation vs frictions

Dependent variable:	CAR(0,1)		
Friction proxy =	-	Shortfall (%)	# missing female directors
	(1)	(2)	(3)
CA HQ (d)	-0.48	0.52	0.56
	(0.29)	(0.43)	(0.51)
CA HQ (d) × Policy sensitive firm (d)	-1.92**	-1.85**	-1.89**
	(0.75)	(0.74)	(0.75)
Policy sensitive firm (d)	0.22	0.16	0.19
	(0.50)	(0.49)	(0.50)
CA HQ (d) × Friction proxy		-4.36**	-0.62**
		(1.73)	(0.29)
Friction proxy		1.58	0.10
		(1.15)	(0.18)
Constant	-1.88***	-2.26***	-1.91***
	(0.51)	(0.70)	(0.68)
Controls	Yes	Yes	Yes
R^2	0.02	0.02	0.02
N	1,238	1,238	1,238

Spillover effects

Dependent variable:	CAR(0,1)							
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Impending quota (d)	-0.83**							
	(0.35)							
U.S. Climate Alliance (d)		-0.87***						
		(0.33)						
GhG reduction policies (d)			-0.66**					
			(0.33)					
Excess minimum wage ($)				-0.22**				
				(0.09)				
Cannabis legalization score					-0.29**			
					(0.14)			
Regulatory score (JL)						-0.32**		
						(0.13)		
Regulatory score (Cato)							-0.17	
							(0.13)	
% votes Democrats								-3.93**
								(1.93)
Constant	-1.23**	-1.01	-1.14*	-1.07*	-0.76	-0.37	-0.90	0.40
	(0.62)	(0.63)	(0.63)	(0.64)	(0.71)	(0.73)	(0.74)	(1.09)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
R^2	0.01	0.01	0.01	0.01	0.01	0.01	0.01	0.01
N	780	780	780	756	780	778	778	780

Spillover effects: Impending legislation vs. frictions

Dependent variable:	CAR(0,1)							
X =	Impending quota (d)	U.S. Climate Alliance (d)	GhG reduction policies (d)	Excess minimum wage ($)	Cannabis legalization score	Regulatory score (JL)	Regulatory score (Cato)	% votes Democrats
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
X	-0.54	-0.97*	0.03	-0.27**	-0.45**	-0.23	-0.05	-2.67
	(0.54)	(0.52)	(0.52)	(0.13)	(0.22)	(0.19)	(0.19)	(3.11)
Policy sensitive firm (d)	0.78	1.14	1.19	1.24*	1.94	1.06	2.65*	7.19**
	(0.63)	(0.73)	(0.78)	(0.66)	(1.19)	(1.37)	(1.48)	(3.04)
X × Policy sensitive firm (d)	-1.79*	-1.66*	-1.94**	-0.51**	-0.69*	-0.27	-0.69*	-13.84**
	(0.93)	(0.97)	(0.95)	(0.24)	(0.42)	(0.39)	(0.37)	(5.74)
Shortfall (%)	1.38	0.56	2.20	0.18	-1.66	2.13	2.03	1.12
	(1.45)	(1.61)	(1.46)	(1.77)	(2.93)	(2.90)	(3.32)	(6.00)
X × Shortfall (%)	-0.29	1.33	-1.97	0.50	1.05	-0.23	-0.18	0.42
	(2.18)	(2.09)	(2.15)	(0.54)	(0.89)	(0.79)	(0.87)	(11.68)
Constant	-1.93**	-1.60*	-2.09**	-1.59*	-0.91	-1.33	-1.96*	-0.86
	(0.87)	(0.90)	(0.87)	(0.94)	(1.11)	(1.06)	(1.03)	(1.75)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
R^2	0.02	0.02	0.02	0.02	0.02	0.02	0.01	0.02
N	780	780	780	756	780	778	778	780

Conclusion

- Frictions in the director labor market explain part of the negative announcement returns of CA firms.
- They do not explain the negative spillover effects on non-CA firms.
- We propose that shareholders take the introduction of a gender quota as a signal that future legislation of non-economic values will follow.
- Shareholders do not appreciate legislation that forces companies to achieve non-monetary goals.
- The negative stock market reaction to the quota’s adoption is mostly unrelated to the appointment of female directors.
- Even cost-neutral policies may have adverse stock price effects, if associated with a perceived shift towards stakeholder value maximization.