Why women make better directors

Chris Bart*

DeGroote School of Business,
McMaster University,
Ontario L8S-4M4, Canada
E-mail: bartck@mcmaster.ca
*Corresponding author

Gregory McQueen

School of Osteopathic Medicine in Arizona,
A.T. Stills University,
Arizona 85206, USA
E-mail: gmcqueen@atsu.edu

Abstract: The positive correlation between the presence of female directors on boards and corporate performance suggests that women appear to make better directors than men. But why? Using the Defined Issues Test (DIT) instrument (Rest, 1979, 1986), 624 board directors (75% male; 25% female) were surveyed to determine their reliance on three reasoning methods (i.e., 'Personal Interest', 'Normative' and 'Complex Moral Reasoning' or 'CMR') to make decisions. The results showed that female directors achieved significantly higher scores than their male counterparts on the CMR dimension which essentially involves making consistently fair decisions when competing interests are at stake. Since directors are compelled to make decisions in the best interest of their corporation while taking the viewpoints of multiple stakeholders into account, having a significant portion of female directors with highly developed CMR skills on board would appear to be an important resource for making these types of decisions and making them more effectively.

Keywords: women directors; corporate governance; director recruitment; director selection; women on boards; complex moral reasoning; DIT; defining issues test; governance and nominating committee.

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Biographical notes: Chris Bart is the world's leading authority on organisational mission and vision statements. He is the Founder, Principal and Lead Professor of The Directors College at McMaster University. He has over 170 publications including two Canadian business best sellers for 2012: "*A Tale of Two Employees*" and "*20 Essential Questions Directors of Not-for-profit Organizations Should Ask About Strategy*". He is the recipient of numerous awards and honours. Over the years, he has been invited to lecture at numerous institutions throughout the world. He is listed in Canadian Who's Who and has been a Director on many Boards.

Gregory McQueen is an applied ethicist who lectures in the fields of bio medical ethics, ethics, and cognitive moral reasoning as it applies to leadership decision-making and business management. Skilled as a mediator and planner, he facilitates corporate/board planning, reorganisation, ethical decision making and executive team building. He holds a faculty associate appointment at the Niagara Institute, an international leadership development centre within the Conference Board of Canada. He is a member of the faculty of the Directors College at McMaster University and is a certified executive feedback coach with the Center for Creative Leadership, University of North Carolina.

It's a remarkable anomaly that with women representing 50% of most geographic population groups, they are under-represented in the boardrooms of their nations. Even more amazing is that the typical excuses proffered for this anomaly ("there's not enough talented/educated/experienced females to fill the positions") no longer hold muster – at least not within North American and European jurisdictions. Women now represent more than 50% of the graduates of most universities' professional programs. So there is no shortage in the pool of young women available to start careers climbing the corporate ladder.

As they climb the ladder, however, attrition appears to take its toll such that only about 20–25% of women are represented in the executive suite. Women then become subject to a statistical sampling disadvantage when it comes to being offered memberships in the elite Boardroom Club. Accordingly, the presence of female corporate directors gets 'crowded out' in the un-natural selection process of most Board Nominating Committees with the result that, globally, women have been 'stuck' at around 9% of corporate board memberships[1] – despite the availability of talented, experienced and educated female candidates.

Historically, *gender equality* has been the focus of most arguments for increasing the representation of females in the boardroom which in and of itself is a strong argument for higher numbers of women on corporate boards. Women are just as good as men and so appropriately qualified women should not have to work harder than men to gain those senior leadership positions that are rightfully theirs.

Sadly, though, these arguments are not going to win more board seats for women when the *other gender* controls the board admission criteria and process without restriction or regulation. That's why some countries, such as Norway, have had to impose 40% quotas to raise the proportion of women on their boards. Even Quebec has accepted this reality by legislating 50% gender parity for the boards of its Crown corporations. But not everyone agrees that quotas are the solution preferring instead to nudge corporate boards into gender equality. The US Dodd-Frank Act is trying to do so by forcing greater disclosure of how corporate nomination committees consider diversity in the board selection process. Others, like Denmark and Sweden, have adopted a 'comply or explain' code requiring that diversity be considered in making board appointments.

There is, however, another argument for putting more women on boards which has nothing to do with gender equality. It's that women simply have the capacity to make better directors and their presence on corporate boards has been linked to higher organisational performance. One study, for example, has shown that boards with high female representation experience a 53% higher return on equity, a 66% higher return on invested capital and a 42% higher return on sales (Joy et al., 2007). Another one demonstrates that by having just one female director on the board cuts the risk of bankruptcy by 20%.[2] And other studies have shown that when women directors are appointed, boards adopt new governance practices earlier (such as director training, board evaluations, director succession planning structures) (Singh and Vinnicombe, 2002), become more civilised and sensitive to other perspectives (Fondas and Sassalos, 2000), reduce 'game playing' (Singh, 2008) and ask more questions rather than nodding through decisions (Konrad et al., 2008). So now there is a strong business case for putting more women on boards.

The correlation between the presence of female board members and corporate performance demonstrates that having women on the board is no longer just the right thing to do based on gender equality arguments but also the smart thing to do. Nominating committees, therefore, which ignore this fact may actually be shortchanging their investors' potential for future returns. On a larger scale, boards may even be considered derelict in fulfilling their fiduciary responsibility to act in the best interests of the organisation because, with a limited number of female directors, they are ignoring an easy and obvious way to increase their board's effectiveness and their organisation's probability for success.

But *why* do women make better directors? And how does having a more gender balanced board contribute to better organisational performance. Several traditional – and unproven arguments – have been put forward. One is that women are naturally more risk averse and therefore less inclined to go along with bet-the-company strategies, thereby reducing the risk of bankruptcy. Maybe. Another is that for those industries that cater to women (retail, banking, food), female directors are better able to understand customers' needs and desires. This sounds slightly and suspiciously sexist. Still another is that women come to a board with different ideas, skills and experiences than their male counterparts and that this leads to better decision making. Yet, regardless of gender, all directors must essentially go through the same period of corporate gestation and pass through the same executive birth canal in order to meet a nominating committee's skill matrix requirements. So how different can the 'business experiences' of female and male executives really be?

We would like to propose that there is another heretofore unproven explanation for why women have the capacity to make better directors than men. It is found in their respective, genetically driven, cognitive processes and thinking patterns. So, John Grey was right! Men are from Mars but women are from Venus.

More specifically, our research has found that women on boards are significantly better than men at making decisions because of their 'Complex Moral Reasoning' (CMR) abilities. CMR involves acknowledging and considering the rights of others in the pursuit of fairness by using a social cooperation and consensus building approach that is consistently applied in a non arbitrary fashion. The dramatic importance of this is highlighted when one considers that the role of directors is solely to make decisions or, more precisely, to help the board make decisions.

As a reasoning method, CMR is different from other more conventional and less complex types – of which there are two. The first is personal interest reasoning – or "let's make a deal" – whereby the decision maker is motivated by ego, selfishness and the desire to avoid trouble for self. (This is most often exhibited by young children who largely tend to be motivated by a seek pleasure/avoid pain philosophy). The second is normative reasoning – or “don’t rock the boat” – whereby strictly observing the rule of law or adhering to existing group norms dominates decision making (Orthodox religious communities and strong cultures like Mary Kay or the US Marines would be stereotypical examples using this form of reasoning).

Since all decisions have multifaceted social impact implications affecting one or more individuals or stakeholder groups CMR is a tremendous skill to possess, but particularly at the board level in Canada where directors are compelled to act in the best interest of the corporation while taking the viewpoints of multiple stakeholders into account. It is a superior form of reasoning which logically leads to the higher quality decision making reflected in higher rates of return and lower rates of bankruptcy. And our research shows that CMR is what separates the male and female director.

Nine years ago, we set about to measure the CMR capabilities of a group of directors using a survey instrument known as the “Defining Issues Test” (DIT) (Rest, 1979, 1986). In this test, participants are presented with a series of short case scenarios and asked what they would do and the reasoning process they used to make their decision. One case involved a country going through a famine in which one person in a local village had amassed most of the food supply and was hording it to raise prices. Participants were asked to put themselves in the position of a local townsperson and choose among three options: take the food by whatever means; do not take the food; or not sure. The DIT then assesses the degree to which an individual relies on each of the three reasoning methods (i.e., personal interest, normative and CMR) to make such types of decisions.

Overall, 624 directors agreed to take the test. Interestingly, previous moral reasoning studies of any group have rarely been this large and, to our knowledge there is no study of this magnitude assessing board level directors.

The results of our analysis are shown in Figure 1. Not surprising, the directors – as the elite group in any organisation – appeared to prefer CMR relative to the other two less complex ones and did so at a very high level. Normative reasoning came second which shows that the directors were mindful of existing laws, regulations and group norms when making decisions, but not dominated exclusively by them. Thus, fairness trumps tradition. In stark contrast, however, personal interest reasoning scored the lowest and did so by a very wide margin. This is good news since it indicates that the directors in the sample appear to be predisposed to meeting their fiduciary requirement to act in the best interests of the organisation and to place their loyalty to it above all other considerations. And so, service to someone (or something) else surmounts service to self.

These moral reasoning results speak well of our current directorship community. They show that board members as a group appear to recognise, comprehend, prefer, and function at the most complex level of moral reasoning. As such, they have the capacity required to make a more effective contribution to the success of the board and its decision making than individuals who prefer less CMR methods. They also have a high ability – and need – to understand the moral reasoning used by others. Armed with this knowledge, their goal is to find more effective solutions by consistently engaging others through the skilful use of social cooperation/collaboration and consensus building. Because the world is not black and white for them, they are especially influenced by one major question in all their decision making: What’s the fair (right) thing to do in this situation?

What was most surprising for us in this study, however, occurred when we re-did our analysis based on the gender of the directors of which approximately 75% were male and 25% female. We found that in terms of their use of personal interest reasoning (i.e., the lowest ranked and least complex technique), there was no significant difference between men and women. This signifies that both the male and female directors are equally indifferent about making decisions based largely on personal concerns such as pleasing others or making choices mainly for the purpose of avoiding trouble. In other words, they seldom consider the criteria of "what's in it for me" in their decision-making process.

On the other hand, significant differences were observed between the sexes regarding their reliance on both the normative and CMR methods.

The male directors scored significantly higher on the use of normative reasoning than the females. This suggests that the male directors in our sample study prefer to make decisions using rules, regulations and traditional ways of doing business or getting along. Female directors, in contrast, seem to be significantly less constrained by these same parameters and thus are more prepared to rock the board boat than their male counterparts. Could this be one of the prime motivators for why male dominated boards resist having women on boards? They do not want to have to deal with the challenge of being challenged.

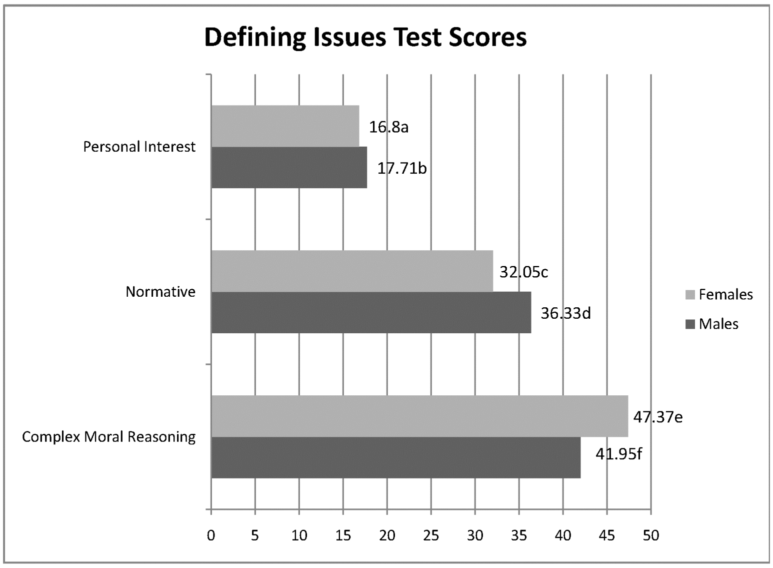
The results of our study, though, appear to be even more dramatic and startling when the CMR scores of the male and female directors were compared. Our results show that the women directors prefer to function using a significantly higher level of complex moral reasoning than the men. This means that female corporate directors are significantly more inclined to work through decision making by taking the interests of multiple stakeholders into account in order to arrive at a fair and morally consistent decision. They will also tend to use cooperation, collaboration and consensus building more often – and more effectively – in order to make sound decisions. Their effectiveness stems from their predisposition to be more inquisitive and to see more possible solutions.

Our results on moral reasoning stand in marked contrast to the previous work of others. For example, in the 1980s, some researchers argued that women did not score as high in the use of CMR as men using the DIT (Gilligan, 1982). By the late 1990s, however, numerous studies concluded that there was no significant difference between men and women and some even found that women scored higher than men (White, 1999). But these past studies provide only snapshots in time. Fast forward to the 2000s and we have a new and vibrant picture of highly effective female board members who now score *significantly higher* than their male counterparts when it comes to CMR.

Our results demonstrate that female corporate directors can make significant contributions to any board through what appears to be their innately superior decision-making framework (i.e., what's fair?) *and* process skills (i.e., consider everyone's point of view). And it is this higher quality decision-making capability which we now posit helps better explain the higher rates of return, more effective risk management and even lower rates of bankruptcy when women are present on the board.

The implications of our findings are significant. Female directors, with their higher CMR skills, appear better able to assess each situation confronting a board more effectively because they are more open to learning, more inquisitive and they actively try to understand the perspective and reasoning of others. Doing so enables them to see more options, alternatives, opportunities and outcomes. Moreover, they appear to be more effective about choosing the right behaviour required to deal with a situation because they are simply better at stepping into and understanding the role/perspective of another person.

Figure 1 DIT means by gender



Note: '*c*' is significantly different from '*d*', and '*e*' is significantly different from '*f*'. There is no significant difference between '*a*' and '*b*'.

Accordingly, we support the view being expressed by others that women will be most effective in the boardroom if they do not try to model their behaviour after men. They will be more effective than their male counterparts if they are simply authentic and use their highly effective CMR talents to help their boards deal with the multifaceted social issues and concerns confronting them in these most complicated and complex times. In short, women make better directors than men. Board Chairs everywhere need to take our findings into consideration in making their next board appointments. And if they do not, it would only seem reasonable to ask: from a fiduciary duty standpoint, in whose best interests are they really serving? Because certainly, it's not the corporation's!

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Notes

[1]Women on Boards: A Statistical Review by Country, Region, Sector and Market Index, Governance Metrics International, March 2009.

[2]Women in the boardroom help companies succeed – Times article March 19, 2009 – Professor Nick Wilson, LUBS.