THE COUNTER-INTUITIVE EFFICIENCY OF THE SOCIAL MOVEMENT TO DIVERSIFY CORPORATE BOARDS

Michal Barzuza (she/her)[1α] & Gideon Parchomovsky (he/his)[2β]

ABSTRACT

Critics of initiatives to diversify corporate boards uniformly rely on efficiency arguments to oppose them. First, they argue that the pressure to diversify boards is motivated by populist sentiments. Second, they claim that if diversity were efficient, corporations would endorse it voluntarily. In this Article, we argue that these so-called efficiency-based claims have merely superficial persuasiveness that does not withstand rigorous economic analysis. In particular, they ignore the pathbreaking work of Nobel Prize laureates Gary Becker and Kenneth Arrow who have pointed out the inefficiencies that discrimination imposes and offered explanations as to why inefficient discrimination may persist for decades.

We demonstrate that the integration of insights from labor economics and corporate finance completely transforms the heated debate on board diversity. Our analysis shows that the underrepresentation of women and minorities on corporate boards is a persistent, inefficient, and highly costly market failure. Discrimination entrenched itself in the corporate domain for three reasons: asymmetric information and prejudice, social networks, and the managerial agency problem. As each of these reasons has been established in the economic literature as a serious impediment to market correction, it is not surprising that market forces did little to enhance the representation of women and minorities on corporate boards. It took the help of public sentiment and ideology, new social norms, intervention on the part of the largest institutional investors, and Nasdaq's unqualified endorsement of the diversity campaign to efficiently open up boards to highly qualified women and minority directors.

Furthermore, we challenge the notion that the empirical evidence does not support board diversity. The position we challenge relies primarily on evidence from more than a decade ago, when diversity levels were not sufficiently high to produce unbiased results, and in contrast to the current pro-diversity movement, were

[1α] Robert Braucher Visiting Professor at the Harvard Law School and Professor at the University of Virginia School of Law.

[2β] Robert G. Fuller Jr. Professor of Law at the University of Pennsylvania School of Law and the Wachtel, Lipton, Rosen & Katz Professor of corporate law at the Hebrew University of Jerusalem Faculty of Law. The authors are grateful to Lucian Bebchuk, Ryan Bubb, Oliver Hart, Kobi Kastiel, Adi Libson, Emily Losi, Paul Mahoney, Holger Spamann, Alex Stein, and Robert Tallarita and particpiants at the Annual Conference of the American Law & Economics Association, for invaluable comments and criticisms. We are especially grateful to Lisa Fairfax for her insightful suggestions. Grace Platt, Paige Reznikov, Shelley Robinson and Ziqian Tao provided excellent research assistance.

adopted voluntarily, potentially by firms that were less in need of the monitoring and independence that diverse boards offer. In fact, a new study that tests for the first time the causal effects of the recent wave of efforts to diversify boards, discussed in this Article, finds a significant positive causal effect of board diversity on firm performance. Our analysis highlights the counter-intuitive efficiency of social movements when markets fail.

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