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Board gender diversity and sustainability reporting quality

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ABSTRACT

Based on the notion that a diverse board will take a more balanced view and pay greater attention to social responsibility and stakeholder concerns, this paper examines the effect of board gender diversity, measured using a range of proxies, on sustainability reporting quality. After controlling for corporate governance as well as firm reporting incentives, reporting behaviour and reporting environment, we find that gender diverse boards are associated with higher quality sustainability reports and independent female directors have greater effect on sustainability reporting quality than female directors. Our findings have implications for policy formulation and provide evidence for a softer 'comply or explain' (as opposed to quota based) approach to encourage board gender diversity and its effects on sustainability reporting quality.

1. Introduction

This paper examines the effect of board gender diversity on sustainability reporting quality. We use five alternative proxies for gender diversity and measure sustainability reporting quality using an index. Our study is based on the UK context which is characterised by a softer comply or explain approach (as opposed to a mandatory one), affecting change in boardrooms and corporate accountability. We provide evidence of gender diverse boards, in particular independent female directors, having a significant positive association with sustainability reporting quality after controlling for corporate governance characteristics and firm reporting incentives, reporting behaviour and reporting environment.

Corporate governance reforms emphasise diversity in boardrooms (Davies Report, 2011, 2015; European Commission, 2014; Higgs Report, 2003). Many companies are now increasingly issuing sustainability reports (Mock et al., 2013; Simnett, 2012).[1] In the UK, the Davies Report (2011) and the Higgs Report (2003) recommended diversifying boards with people from a range of perspectives and backgrounds. Similarly, the European Commission (2012, 2014) has set targets for women on boards and its report on women in decision-making notes that the quality of ethical behaviour in companies is affected by the proportion of females on the board. This paper investigates the relationship between board gender diversity and sustainability reporting quality.

Our examination of the effects of board gender diversity on sustainability reporting quality differs from and extends prior research in a number of ways. *First*, countries differ in their approach to promoting board gender diversity. Unlike the mandatory quota approach adopted, for example, in Norway and Spain, the UK has a voluntary approach to promoting good

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[1] Sustainability reports include quantitative and qualitative information on financial/economic, social/ethical and environmental performance and seek to reflect a company's economic, social and environmental behaviour (GRI, 2013; KPMG, 2011). Sustainability reports are a structured way an entity documents its economic, environmental and social performance that gives companies a means to report on how non-financial factors interact with financial ones and ultimately drive a company's value (Mock et al., 2007, 2013).

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corporate governance practice. The Higgs Report (2003) on the role of non-executive directors argued that diversity on boards can enhance their effectiveness. Subsequently, the Davies Report (2011) recommended that listed companies should establish policy concerning boardroom diversity and set measurable objectives for its implementation. The latest Davies Report (2015) reviewing board gender diversity observes that the UK voluntary approach is working. Unlike prior research on gender effects in accounting which are predominantly based on data from the US (see Gul et al., 2011, 2013; Srinidhi et al., 2011), or Australia (see Capezio and Mavisakalyan, 2015; Chapple and Humphrey, 2014; Hodge et al., 2009) or cross-country (see Junior et al., 2014; Mock et al., 2007; Ruhnke and Gabriel, 2013), our study is based on the UK context where there is a paucity of research on gender effects on sustainability reporting quality. To the best of our knowledge, our paper is the first to provide recent evidence on the effect of board gender diversity, in particular of independent female directors, on sustainability reporting quality.

Second, in focusing on the effect of board gender diversity on sustainability reporting quality, we examine a range of measures of gender diversity: number of female directors on the board, the proportion of female directors on the board, number of independent female directors on the board and the Shannon and Blau indices of diversity. This contrasts, for example, with Liao et al. (2015) whose focus is on the effect of percentage of female directors on whether a firm discloses participation in the carbon emission project.

Third, our focus is not on a particular disclosure, for example whether a company discloses participation in a carbon emission project measured using a dummy (cf Liao et al., 2015), but rather on sustainability reporting quality which we measure using an index.[2] We thus go beyond mere sustainability disclosure. Our focus contrasts, for example, with the cross-country study of Simnett et al. (2009) which does not investigate the effect of corporate governance on sustainability reporting quality. The typology applied in our paper helps in assessing sustainability reporting quality by applying thresholds compared to the dichotomous measure used by Liao et al. (2015) or the two step approach used in Simnett et al. (2009).[3] We also undertake additional analysis and examine specifically the effect of board gender diversity on whether a company has a separate sustainability committee and whether its sustainability report is externally assured.

Fourth, we recognise that sustainability reporting quality could be affected by some underlying firm characteristics. Thus in examining the effect of board gender diversity on sustainability reporting quality we control for the effect of firm reporting incentives, reporting environment and reporting behaviour.[4] We provide evidence that after controlling for these firm related characteristics, board gender diversity has a positive significant association with sustainability reporting quality.

Our paper is related to but also markedly different from Liao et al. (2015): (i) their focus is on examining whether a firm discloses its participation in the carbon disclosure project whereas we focus on sustainability reporting quality; (ii) their study relies on diversity measured using the percentage of female directors whereas we use a number of proxies of gender diversity including independent female directors; (iii) their study does not take into consideration firm specific characteristics that might influence the disclosure of participation in the carbon disclosure project whereas we provide evidence that after controlling for firm reporting incentives, reporting behaviour and reporting environment, gender diverse boards have a positive significant effect on sustainability reporting quality.

Overall, controlling for corporate governance characteristics, reporting incentives, reporting behaviour, and reporting environment, we find that gender diverse boards are associated with higher quality sustainability reports and independent female directors have greater effect on sustainability reporting quality than female directors. Moreover, proxies that capture incentives for more transparent reporting also have a significant and positive association with sustainability reporting quality. Our results are supported by detailed testing of model specification and sensitivity analysis, including tests dealing with size effects and correlated variables issues. Our analysis is based on a sample of companies listed in 2012 in the UK FTSE350, operating under a softer comply or explain approach to governance and board diversity (Adams, 2015), and provides recent evidence on the effect of board gender diversity on sustainability reporting quality.

The remainder of the paper is presented in four further sections. The next section reviews the literature in order to develop hypotheses. The third section sets out the research study in terms of sample, data and model. A fourth section reports the empirical results. The final section provides a summary and draws conclusions.

2. Background and hypotheses development

In this section of the paper we explore prior research related to board gender diversity and sustainability reporting to develop our hypotheses. We do not aim to review the whole literature, but rather focus on papers pertinent to establishing the potential effect of gender diversity on sustainability reporting quality. We first cover sustainability reporting and then gender diversity effects.

[2] This is on a scale of 0–4, whereby we score a firm 0 if it does not publish a sustainability report; 1 = if sustainability report exists; 2 = if sustainability report exists and the company has a sustainability committee affiliated with the board of directors; 3 = if sustainability report exists and the report is assured by an external assurer provided by a non-audit firm; score 4 = if sustainability report exists and is externally assured by one of the Big 4 or other audit firm.

[3] Simnett et al. (2009) used a dummy variable taking the value of 1 if sustainability reports are assured and 0 otherwise in the first step, whereas in the second step, it tests whether the assurance provider belongs to the audit profession.

[4] We follow Daske et al. (2013) and use factor analysis technique in controlling for these firm specific characteristics.