NASDAQ should not use academics as an excuse for imposing a diversity agenda

On December 1st NASDAQ the Nasdaq Stock Market filed with the Securities and Exchange Commission a proposal to adopt Rule 5605(f) (Diverse Board Representation), which would require Nasdaq-listed companies, subject to certain exceptions, (A) to have at least one director who self-identifies as a female, and (B) to have at least one director who self-identifies as Black or African American, Hispanic or Latinx, Asian, Native American or Alaska Native, Native Hawaiian or Pacific Islander, two or more races or ethnicities, or as LGBTQ+, or (C) to explain why the company does not have at least two directors on its board who self-identify in the categories listed above.

One justification for this proposal is mentioned on page 3 of the report:

"Nasdaq reviewed dozens of empirical studies and found that an extensive body of ***academic*** *r*esearch demonstrates that diverse boards are positively associated with improved corporate governance and financial performance". [1]

On page 18 of the proposal NASDAQ provides the list of 17 studies that prove that diversity improves shareholder value. A closer inspection reveals that 9 studies that provide support for the diversity agenda are written by consulting firms, asset managers and banks, not by academics.

In contrast to studies by practioners, academic research is subject to the referee process. One of the main concerns of studies that find positive correlations between diversity and measures of financial performance such as ROE, ROIC, EBIT margin and stock returns is endogeneity. Correlation does not mean causality. Endogeneity problems could be a result of the fact that financial performance and diversity are correlated with an unknown unidentified variable.

Or there could be reverse causality if firms with high performance tend to put women on the board. For example, one study finds correlations between diversity measures in 2014 and economic performance in the *previous* 3 years. Although the studies admit that correlation

[1] https://listingcenter.nasdaq.com/assets/RuleBook/Nasdaq/filings/SR-NASDAQ-2020-081.pdf, page 3

does not imply causality, the NASDAQ proposal suggests that the studies indeed imply causality. Academic studies pay a lot of attention to control for reverse causality and properly adjust for risk.

That's why from the all the academic studies cited by NASDAQ that are published in refereed Journals, only 3 support the thesis that diversity increases shareholder value. Most studies cited find no effect or a negative effect on financial performance.

Moreover, NASDAQ does not cite the most relevant studies, studies that show significant stock price declines after *mandatory* diversity regulations in Norway (Ahern and Dittmar, 2012; Matsa and Miller, 2013)[2] and California (Greene et al (2020)[3]. These studies should be of particular relevance as they deal with mandatory, not voluntary diversity, which is the core of the NASDAQ proposal. NASDAQ also does not cite many other academic papers that report negative consequences of diversity for shareholder value such as Solal and Snellman (2019)[4] . Although his article received a lot of publicity in the popular press[5] it is not cited in the NASDAQ proposal.

In short, if NASDAQ wants to push for diversity for other reasons (which we don't question) it should not hide behind the claim that academic research has shown the positive effect on financial performance. It could simply point at the fact that large asset managers such as Black Rock, State Street and Vanguard are pushing for gender diversity on Boards[6]. So investors may care about non-financial benefits (alpha in heaven) than financial benefits (alpha on earth) when picking stocks. The argument is similar to the argument that some

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2 https://www.researchgate.net/publication/227345676_The_Changing_of_the_Boards_The_Impact_on_Firm_Valuation_of_Mandated_Female_Board_Representation; https://www.aeaweb.org/articles?id=10.1257/app.5.3.136

3 https://www.sciencedirect.com/science/article/abs/pii/S092911991930375X?via%3Dihub

4 https://pubsonline.informs.org/doi/10.1287/orsc.2019.1301

5 E.g. https://www.forbes.com/sites/kimelsesser/2020/07/20/increasing-diversity-and-profits-investors-think-companies-cant-do-both/ and https://www.ft.com/content/9c185e78-11e0-11ea-a7e6-62bf4f9e548a

6 file:///C:/Users/Vermaelen/Downloads/SSRN-id3724653%20(1).pdf

investors are averse to sin stocks[7] and others like sustainability, although such decisions lower expected returns[8] .

The good news is that the proposal allows companies to explain why they are not complying with the diversity requirements. Our suggestion to these firms is to simply refer to the academic evidence, especially evidence that shows the negative consequences of mandatory gender quotas.

[7] https://fif.hebis.de/xmlui/bitstream/handle/123456789/755/216_SSRN-id3206538.pdf?sequence=1&isAllowed=y

[8] https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3016092