Initial appraisal of a European Commission Impact Assessment

European Commission proposal for a Directive on improving the gender balance among non-executive directors of publicly listed companies


- **Background**

This note seeks to provide an initial analysis of the strengths and weaknesses of the European Commission's Impact Assessment (IA) accompanying the proposal for a Directive on improving the gender balance among non-executive directors of companies listed on stock exchanges and related measures.

- **Context**

Promoting equality between women and men is one of the EU's main objectives, as reflected in its Treaties (Article 3(3) TEU and articles 8 and 157 TFUE), as well as in the Charter of Fundamental Rights (Article 23). The EU institutions have undertaken various efforts over several decades to promote gender equality in economic decision-making, notably to enhance female presence on company boards, by Recommendations and by encouraging self-regulation. Following the adoption of Council Recommendations on the promotion of positive action for women (84/635/EEC) in 1984 and the balanced participation of women and men in the decision-making process (96/694/EC) in 1996, the Commission identified equality in decision-making as one of the priorities of its Women's Charter (COM (2010)78 final) and of its strategy for Equality between Women and Men 2010-2015 (COM (2010) 491 final) in 2010.

The issue of enhancing female participation in economic decision-making has recently become increasingly prominent, focusing particularly on the economic dimension of gender diversity and the benefits that more gender-diverse boards can have on company performance and ultimately on growth and the attainment of the objectives of the Europe 2020 Strategy and its target of increasing the employment rate of women to 75% by 2020.

In March 2011, Commission Vice-President Reding launched the 'Women on the board pledge for Europe', calling for publicly-listed companies to voluntarily commit to increasing the proportion of women in boardrooms to 30% by 2015, and 40% by 2020. By 2012, only 24 companies had signed the pledge.

At the same time, the European Parliament called upon the Member States to increase the representation of women in decision-making bodies and invited the Commission to propose
legislative quotas to increase female representation on corporate boards to 30% by 2015 and 40% by 2020 if the voluntary measures failed to produce results.

Despite the various efforts undertaken at EU and national level, persistent gender imbalances in corporate leadership positions remain. According to the Commission's data, only 13.7% of seats on the boards of the largest listed companies are currently held by women (15% among non-executive directors), despite the fact that women not only possess the educational and professional credentials to participate in such bodies, but are also willing and available in sufficient numbers to do so (IA, p. 5). Progress in increasing the presence of women on company boards has been very slow, with an average annual increase between 2003 and 2012 of just 0.6 percentage points. (Female representation on boards of publicly listed companies has increased from 8.5% in 2003 to 13.7% in 2012). The rate of improvement in individual Member States has been unequal and has produced highly divergent results. Until the end of 2011, only 11 Member States had adopted laws establishing quotas or targets for gender representation on company boards. The remaining Member States have taken no action (IA, p. 9). The Commission estimates that, at the current rate of progress, it would take more than 40 years for companies across the EU to achieve balanced gender representation on their boards (IA, p. 22 footnote 58).

The Commission stresses that the under-representation of women on company boards is both a cause and an effect of persistent gender inequalities in society as a whole and that the present proposal should be seen in this wider policy context.

- **Problem definition**

The IA identifies the following problems associated with the under-representation of women on boardrooms (executive summary, p. 2-3):

1. Female under-representation in the boardrooms of publicly-listed companies in the EU represents a missed opportunity to make full use of the EU’s human capital, as under-utilising the skills of highly qualified women is a loss of economic potential for individual companies, as well as for the economy as a whole: first, gender imbalance in company boards is a missed opportunity at company level both in terms of corporate governance and financial company performance; secondly, the under-representation of women has negative spill-over effects on the wider economy, since it contributes to the gender employment gap and feeds into the gender pay gap;

2. The current lack of women in boardrooms generates a vicious circle which perpetuates the under-representation of women in decision-making;

3. Divergence or the absence of regulation at national level also poses barriers to the internal market, by imposing divergent corporate governance requirements on European listed companies. These differences can lead to practical complications for listed companies operating across borders, as well as for candidates for board positions.

While the problem definition section appears to have been substantially improved, as a result of the Commission's Impact Assessment Board's recommendations, several of the Commission's working assumptions, also criticised by the Board, still appear to be weakly evidenced or not evidenced at all: for example, the Commission's assumption that increased female participation in company boards will have 'positive spill-over effects' on all levels of female employment.

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within a company, on female salaries and on the wider economy (IA, p. 12-13) seems to rely on the findings of a single study undertaken in the United States. It would have been useful in this regard to obtain information on whether the existing national policies establishing quotas or targets for gender representation on company boards have had the ‘pull’ and ‘push’ effects the Commission expects.

The Commission also recognises very transparently that no causal link has been established between the share of women on boards and financial performance of companies, studies mainly pointing at the existence of a positive correlation between those two factors.

Furthermore, the Commission does not appear to provide evidence for the practical complications (such as exclusion from public procurement or restriction on freedom of movement for candidates) which can have a negative impact on the internal market and does not seem to address this issue further in the impact assessment.

The Commission considers that the primary problem drivers are the ‘glass-ceiling’ or ‘demand-side barriers’ which block women from advancing to company board positions and manifest themselves through gender stereotypes barriers, a male-dominated business culture and recruitment processes barriers (lack of transparency). Although the Commission recognises the continued existence of supply-side barriers - such as reconciliation of work and private life, insufficient childcare and segregation in the labour market - which block the career advancement of highly qualified women, it considers without providing any evidence that ‘for women who are just one step below board positions, supply-side barriers play no significant role any more’ (IA, p. 17) and therefore does not address this aspect in its analysis. A clearer understanding of what makes women strive for greater leadership responsibility and what convinces them to stay put would have been useful in this regard.

In line with the recommendations of the Commission’s Impact Assessment Board (IAB), the baseline scenario contains information about Member States’ individual situations and the situation in different sectors. The IA contains a whole annex dedicated to the baseline scenario (annex 6), explaining the methodology used to calculate the change in female presence in boards by 2020 as well as the natural trend in each Member State.

On the basis of past trends and taking into consideration the recent introduction of national measures, the Commission estimates that, without further EU action, female representation among non-executive directors will grow from 15% in 2012 to 24% in 2020 (which the Commission argues is below the critical mass of 30% which has been identified as being necessary to produce significant effects on corporate governance and performance), bearing in mind that 15 Member States have taken no action to date. In order to produce these estimates, the Commission has taken into account each country’s current regulation (or absence of regulation) and assumed that the trend observed during the period 2003-2011 will continue throughout the period 2012-2020 (linear model). The IA does not appear to include a ‘sensitivity analysis’ to see whether the results would be different if the 15 Member States that have not acted so far were to act in the future, a scenario which the Commission seems to exclude from the outset.

**Objectives of the legislative proposal**

The ‘general’ objectives of the Commission proposal are: i) to promote gender equality in economic decision-making, specifically in the boardrooms of listed companies, in line with Article 3 (3) TEU, and ii) to fully exploit the existing talent pool for more equal gender representation on company boards, thereby contributing to the proper functioning of the internal market and to the Union’s Europe 2020 objectives.
These general objectives are translated into two 'specific' objectives: i) to reduce the 'demand-side' barriers women face when aiming for board positions; and ii) to improve corporate governance and enhance company performance.

The Commission also identifies the following corresponding 'operational' objective: to introduce a common (non-binding or binding) objective for the share of each gender on boards of publicly listed companies in the EU.

- **Range of the options considered**

The following three policy options were discarded at an early stage of the impact assessment, but with thorough explanations (IA, p. 32):

1. **More self-regulation**: this option was considered by the majority of the business community as the most appropriate approach, on the grounds that (in their view) it allows taking into account the starting point of different companies and sectors and provides for tailor-made solutions. The Commission discarded this option arguing that, at EU level, various attempts have been made to encourage self regulation, but with very limited success, and that, at national level, the effectiveness of self-regulation has proven to be very limited. Therefore, such an option would not meet the policy objectives;

2. **Increased transparency of the board selection processes as a stand-alone measure**: The Commission rejected this option, stressing that a measure regulating selection procedures for board members risks to disproportionately interfere with a company's individual recruitment processes and with national company law;

3. **Increasing female participation in decision-making beyond the private sector**: The Commission discarded this option, arguing that female under-representation in decision-making positions is a less acute problem in other sectors, such as public administration, the judiciary and NGOs, and that the management structure of many of these sectors is different from companies, making it more difficult to define gender objectives without violating the ECJ's case law regarding positive action. It also argued that, due to the organisational autonomy of Member States, the competence of the EU to intervene in matters of management appointments in the public sector will be heavily contested. Additionally, the public sector was not considered problematic in the public consultation (IA, p. 34).

The IA then screened the remaining policy options against different criteria:

- **The scope of the options: which companies should be covered?** The Commission concluded that in order to meet the policy objectives, policy options should focus on publicly listed companies, with the exception of SMEs, because of their higher visibility and the fact that they set standards for the private sector overall (IA, p. 35);

- **The degree of ambition of the different options**: The Commission indicated that the level of the objective in the retained policy options is assumed to be 40%, since it is in line with the targets currently under discussion at EU level and with the demands of the European Parliament. This percentage lies between the critical mass of 30% and full gender parity 50% (IA, p. 37);
Deadline for compliance: the working assumption is compliance by 2020, since this timeline corresponds to the one discussed at EU level and called for by the European Parliament. The Commission also says it is realistic and leaves companies sufficient time to prepare (IA, p. 38);

Requirements of ECJ case law: The Commission indicates that the retained policy options cannot impose rigid quotas, but should respect the ECJ's case-law on positive action and the principle of proportionality, allowing for companies to justify, under special conditions, why they could not comply with the target, in particular in cases of a lack of equally qualified candidates or the under-representation of women within the workforce. Furthermore, in line with the case-law and the principle of proportionality, it was also assumed that the retained policy options will only be pursued on a temporary basis until sustainable progress has been achieved (IA, p. 39).

The following five policy options were retained for further consideration and assessment:

1. No further action at EU level (baseline scenario): this means self-regulation and voluntary measures;
2. A Commission Recommendation encouraging Member States to achieve an objective of at least 40% if board members of each gender by 2020 for both executive and non-executive directors of publicly listed companies in the EU;
3. A Directive introducing an objective of at least 40% of each gender by 2020 for non-executive directors of publicly listed companies in the EU;
4. A Directive introducing an objective of at least 40% of each gender by 2020 for non-executive directors of publicly listed companies in the EU and, in addition to option 3, also a flexible objective for executive directors which would be set by the publicly listed companies themselves in the light of their specific circumstances;
5. A Directive introducing an objective of at least 40% of board members of each gender by 2020 for both executive and non-executive directors of publicly listed companies in the EU.

In response to the IA Board's request, the Commission IA now discusses briefly more feasible and proportionate variations of the options for binding quotas, such as longer compliance periods and/or lower targets for quotas (for example 30% as required in some Member States). However, it indicates that, in order to keep the number of options considered manageable and in view of the fact that the effects of a lower objective (30 or 35%) will be proportionately less, the IA does not assess in detail the exact impacts of other conceivable target levels (IA, p. 38, footnote 90).

The IA concludes that all policy options are expected to address the main drivers of the problem and would help to reduce the importance or even break the ‘vicious circle’ explaining and maintaining female under-representation in corporate board rooms (IA, p. 58). From the comparison of the options, it would appear that binding measures are more effective in meeting the policy objectives and generate more societal and economic benefits than non-binding measures and that measures that target both executive and non-executive board members are more effective that measures only targeting one group. The proposal is based on option 4.

Scope of the Impact Assessment

All the options retained are assessed for their social and economic impacts, as well as for their effectiveness, investment costs (training, mentoring, use of search firms to find external candidates) and administrative burden, compared to the baseline scenario.

For example, the preferred policy option 4 is expected to lead to a total annual burden of monitoring for all Member States of 100,000 euro and a total annual cost of reporting for all
companies in the EU of 124,000 euro; the total annual investment costs in the EU for the period 2017-2020 will amount to roughly 18.3 million euro and roughly 3.5 million euro for the period 2021-2030. The average annual investment costs per company are estimated at 4,821 euro for the period 2017-2020 and 915 euro for the period 2021-2030. The Commission says that, while non-negligible, these investment costs are very modest in relation to the benefits at company level which are estimated at 3.5 million euro for an average company. (Under option 4, the average return on equity would increase by 0.32 per cent, or 2.92 per cent compared to the baseline, which is equivalent to an increase in the net income of listed companies of about 17.5 billion euro) (IA, p. 53-54).

No environmental impacts were found.

As far as economic impacts are concerned, the options are assessed for their impacts on corporate governance (nine corporate governance indicators are used), on financial performance and on long-term economic growth.

The analysis is both qualitative and quantitative, except for the impacts on long-term economic growth, which are only scored qualitatively, due to a lack of data. The methodology for calculating the impacts is clearly explained in annex 8.

The impact of the different policy options on the affected fundamental rights (Articles 16 (freedom to conduct a business) and 17 (right to property) of the EU Charter of Fundamental Rights) is carried out in the assessment of the policy options and in more detail in annex 7.

- SME test

SMEs are excluded from the proposal and, therefore, no SME test was performed.

- Subsidiarity and proportionality

The proposal is based on Article 157 (3) TFEU. The Commission advances three arguments to justify EU action. First, it says that, on the basis of the concrete indications by Member States regarding their intentions and on the projections derived from all available information, Member States acting individually will not achieve the objective of a more balanced gender representation on company boards in line with the policy objectives set out in this proposal by 2020 or at any point in the foreseeable future. Second, the Commission suggests that the different regulatory approaches taken by Member States can have a negative impact on the internal market and lead to practical complications, whereas common minimum standards help to ensure a 'competitive level playing field'. The third justification for EU action places gender equality within the broader social and economic context of the Europe 2020 strategy.

By 15 January 2013, the national parliaments of five Member States - Poland, Sweden, the Netherlands, the United Kingdom and the Czech Republic - had issued a reasoned opinion, raising issues with respect to the subsidiarity principle.

In its second opinion of 10 August 2012, the Commission's Impact Assessment Board had found that 'he evidence base to demonstrate the need for, and proportionality of, binding EU action remains very weak'.

The proportionality of the proposal is addressed in the IA.
• **Budgetary or public finance implications**

The Commission argues that the proposal would have no impact on the European Union budget. However, the proposal will entail investment costs for companies, the amount of which will depend on the current level of female participation in corporate boards in each Member State, the existing provisions already introduced in each Member State and the policy option in place. It will also entail administrative burdens both for companies (reporting costs) and Member States (monitoring costs). The IA states that the administrative burden linked to all policy options assessed is expected to be minimal and identical per company and Member State for all retained policy options (IA, p. 59).

• **Stakeholder consultation**

The proposal was preceded by a public consultation in 2012. In line with the IA Board's recommendations, DG JUST indicates the various stakeholder positions in the analysis of the options and their impacts. The full results of the stakeholder consultation are provided in Annex 2.

• **Quality of data, research and analysis**

The IA contains both a qualitative and quantitative assessment of the expected impacts of the different options, and, where quantification was not possible, an explanation was provided. However, no table of costs and benefits is provided. While the limitations are acknowledged, the IA does not appear to contain a sufficiently thorough analysis of the potential risks linked to a binding measure, the IA indicating that any possible additional short-term risks have to be considered very limited, and that quantification of the risks was not possible (IA, p. 51 and 54). For example, the Commission only briefly assesses the risk of any short-term negative impacts on company performance due to the imposition of a binding quota by law, as highlighted by some studies analysing the effects of the Norwegian legislation; it also does not appear to address the risk for companies of not finding enough interested female candidates to fill the quota and the consequences this would entail or the risk that companies could circumvent the quota obligation through the comparative analysis of the qualifications of each candidate which they must undertake.

The IA is based on a wide range of internal and external studies, a full list of which is provided in annex 1. The methodology to calculate the impacts and all the quantified data are based on a study carried out by Matrix Insight Ltd, at the Commission's request, on possible EU measures on gender quotas in boardrooms.

• **Commission Impact Assessment Board**

The Commission's IA Board issued a very critical opinion on the first draft of the IA on 20 June 2012. It issued a further opinion on the resubmitted draft IA on 10 August 2012. In the latter, it recommended that the text: i) include greater evidence on the reasons why the objectives of the proposed action cannot be sufficiently achieved by Member States themselves, given their proven ability to act in this area; ii) discuss the reasons for the relatively strong gender balance performance of the public sector without the need for EU legislative action; iii) consider a broader set of options and develop more proportionate variations of the options for binding quotas; iv) include more precise information on the content of the options and on the nature and impact of the flexibility clause in different Member States; and v) present the different stakeholders' views throughout the whole report.
As a consequence, DG JUST seems to have partially addressed this criticism, inter alia, by strengthening the problem definition with the provision of a comprehensive overview of the existing situation at national level, by discussing the differences with the public sector, and by including stakeholders' views throughout the IA (although not in the section relating to the problem drivers). Nevertheless, the IA Board's request that the Commission develop more proportionate variations of the options for binding quotas appears to have been poorly addressed, since the IA indicates that it does not assess in detail the exact impacts of other conceivable target levels and rejects almost from the outset longer compliance periods. In addition, the request for the economic impacts to be summarised in a table does not appear to have been followed, and nor does the request that the income estimates be presented with the necessary degree of caution, given the methodological uncertainties.

- **Coherence between the Commission’s legislative proposal and IA**

The IA and the Commission proposal appear to correspond. The proposal is based on option 4 of the IA.

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This note, prepared by the Impact Assessment Unit for the Committee on Legal Affairs and the Committee on Women's Rights and Gender Equality, analyses whether the principal criteria laid down in the Commission’s own Impact Assessment Guidelines, as well as additional factors identified by the Parliament in its Impact Assessment Handbook, appear to be met by the IA. It does not attempt to deal with the substance of the proposal. It is drafted for informational and background purposes to assist the relevant parliamentary committee(s) and Members more widely in their work. This document is also available on the internet at: [http://www.europarl.europa.eu/committees/en/studies.html](http://www.europarl.europa.eu/committees/en/studies.html)

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Manuscript completed in February 2013


DOI 10.2861/13570

CAT BA-31-13-617-EN-C