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Diversity

Investors Influence on Diversity in German Boards

Asset managers making board diversity investment criterion for portfolio companies. Large German companies with board members of similar profiles could lose out, reveals scientific study of HWR Berlin

Something is happening in the capital markets. Increasingly, asset managers are making board diversity an investment criterion for their portfolio companies. Large international investors such as BlackRock, Federated Hermes, Norges and Amundi request that sufficient gender diversity, a broad skill set, international perspectives and/or ethnic minorities are represented on issuers' boards. The fact that executive and supervisory boards of large German companies continue to be composed of members with largely similar profiles could become fairly risky in terms of the companies' access to equity capital. The study provides comprehensive insights into the extent to which the largest investors in the German market are using their influence to demand more diversity.

In a comprehensive study, an experts' network from the Berlin School of Economics and Law analyzed to what extent institutional investors influence German supervisory and executive board diversity. In light of the ongoing homogenous composition of many German executive and supervisory boards, the question arises whether investors use their influence to increase diversity. What leverage do large investors actually have? What are their diversity requirements for their portfolio companies? Which investors pay only lip service to diversity and who is serious about it?

Generally speaking, the role of equity investors in German corporate governance has increased significantly. The law on the implementation of the second shareholder rights directive (ARUG II) has strengthened the influence of shareholders and, thus, in particular, the influence of institutional investors on corporate governance. However, according to the calculations reflected in the study, the 30 most influential institutional investors in the DAX® and MDAX® only hold 23 percent of the voting rights of the companies included in these indices. The remaining voting rights are attributable to unidentifiable investors and large anchor investors.

Based on their investment guidelines, 15 of the 30 most influential institutional investors stipulate board diversity requirements for their portfolio companies. Investors are becoming increasingly aware of the emerging correlation between diversity and financial performance and want to avoid business risks that may result from group think in homogeneous teams.

However, in the German corporate governance system, it is not easy for investors to make a targeted and effective push for more diversity in their portfolio companies. Accessing information on the level of diversity in companies is often difficult. In some cases, finding the relevant information can be time-consuming, and the responsibility for diversity within the supervisory board may also be unclear.

In addition, primarily foreign investors lack a clear understanding of the particularities of the dualistic German corporate governance system, which is characterized by the existence of two distinct boards, the executive board and the supervisory board, rather than a single board of directors. Investment guidelines stipulating diversity requirements without distinguishing between the executive board and the supervisory board are not sufficiently tailored to the German corporate governance system and are largely ineffective in terms of steering behavior.

In sum, in the 2020 general meeting season, only 48 percent of the institutional investors voted in line with their diversity requirements when voting on supervisory board candidates. By contrast, 52 percent – the majority of the voting rights – were voted contrary to the investor's diversity requirements or not voted at all. During the last general meeting season, none of the investors analyzed championed diversity both through its investment guidelines and through its voting behavior.

The study puts forward a number of recommendations on how investors can be more effective and broaden their influence on German executive and supervisory board diversity. If diversity is important in an investor's investment strategy, the diversity requirements for portfolio companies should be clear and tailored to the German context. If the German government wants to leverage the influence of investors for purposes of creating gender parity, the legislator should simplify diversity-related disclosure obligations of issuers, standardize the disclosure format and improve the accessibility of information ("What gets disclosed, gets discussed."). Lastly, retail investors can express their preference by investing their money through asset managers who care for diversity.

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- **The Study** (Download available in German)

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