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Future-proofing Company Leadership: Board Diversity in EURO STOXX 50 Companies

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Research for this study was conducted in cooperation with Kepler Cheuvreux.



Future-proofing Company Leadership: Board Diversity in EURO STOXX 50 Companies

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Key findings

- The rise of emerging markets—a source of economic growth and revenues for multinational firms—is placing diversity at the forefront of today's corporate governance agenda.
- European nationals make up 84% of board members in the 50 largest European companies by market capitalisation while a mere 5.6% of board directors are nationals from an emerging market.
- Regarding women in the workforce, there is an observable *hourglass effect*: the percentage of women at the employee level is higher (at 35%), lower at the senior executive level (11%), then higher again at the board level (18%).

In many respects, the largest European corporations are truly international enterprises - they have clients, employees, supply chains, shareholders, regulators and additional stakeholders spread across the globe. However, the impacts of globalisation remain to be fully seen at the board level. The rapid rise of emerging economies is placing diversity at the forefront of today's corporate governance agenda. In fact, research now points to a link between greater diversity at board level and a company's positive financial performance. Up to the present time, diversity as a topic has largely been focused on gender balance; nevertheless, other aspects such as nationality can increasingly be seen as a means to bring a broader range of views and experiences to bear in the leadership of European companies. With this in mind, we analysed board diversity among the largest 50 European companies by market capitalisation. The results suggest that companies need to bolster senior management and boards in order to improve their chances of success in emerging markets.

Planning for the future

The role of the board in modern, multi-national corporations is to ensure proper leadership and governance through oversight of a company’s activities on behalf of shareholders, as well as collective responsibility for the firm’s long-term success. The board’s ability to do so naturally depends on having the right mix of directors with the right skill, background and experience to enable the board to discharge its collective leadership function.

As companies increasingly look to emerging markets for new revenue growth, the need for board directors with backgrounds from these markets will come to the fore. Succession planning for board directors should, in our view, take this long-term structural shift into account.

European firms go global

Starting in the 1990s, European large companies rapidly transformed from either domestic or regional players to international businesses better described as rooted in Europe but with a global outlook.

There are a number of reasons behind this:

- First, companies needed growth beyond European markets in order to survive and prosper in a worldwide marketplace.
- Second, geographic diversification became a strategic goal for many in order to reduce risk and smooth the volatility of returns.
- Third, from a cost control perspective, supply chains extended further across the globe. Following the rise of China, competition mounted for natural resources in often-remote locations.
- Fourth, shareholders became a more diverse group as foreign investors raised their stakes in European-listed companies¹.

In this way, corporate geographic footprints have become global, as illustrated in Figure 1.

Figure 1: Corporate footprints are now global



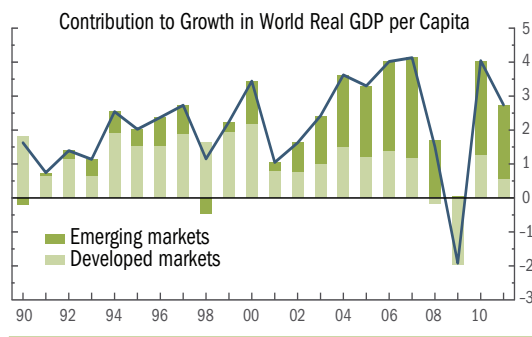
Source: AXA Investment Managers.

However, **one element of corporate Europe has not kept pace with this broad international shift: the boardroom.** Our analysis shows that European nationals make up 84% of board directors at the fifty largest European firms even though a significant proportion of tomorrow’s economic growth will come from outside of Europe.

¹ FESE (The Federation of European Securities Exchanges) and Eurostat surveys show that about 40% of European listed companies are held by foreign investors.

Since the global financial crisis, emerging markets have led global GDP growth, as shown in Figure 2. In the near future, emerging markets are expected to overtake advanced economies as the largest contributors to global GDP

Figure 2: Emerging Markets Have Led Global GDP Growth



Sources: World Economic Outlook database; World Bank World Development Indicators Oct 2012. Database; Penn World Tables 7.0; and IMF staff calculations.

Most large European companies, facing weaker growth prospects in traditional markets, are predicating future growth on the build-out of infrastructure, attractive wage dynamics and growing consumer demand in emerging economies.

In fact, for many of the larger European companies, the ability to generate, preserve and enhance sustainable shareholder value over the long term depends on how well they manage activities outside their home markets.

A stark statistic brings clarity to this trend: with global GDP growth tilted towards emerging markets, these economies should account for most of the 70 million new consumers expected to enter the global middle class each year; a total of 800 million by 2020².

This rather large number conceals a less well-known fact: much of tomorrow’s consumer spending power

in emerging markets will be in the hands of women. Given the rise in women’s participation in labour markets and education across the world, **the total amount of women’s disposable income in emerging markets will likely surpass the total amount of overall disposable income in Europe by 2020**, according to Deloitte. In light of these projections, companies in advanced economies that hope to capture this growth will need to have the right skill sets in place to succeed in these markets.

There is academic support for the idea that diversity improves decision-making by fostering creativity and innovative problem-solving, effectively reducing the risk of groupthink

A diversity premium?

A number of recent studies have explored the potential link between corporate board diversity—which entails a mix of nationalities, backgrounds and gender balance—and a company’s performance. According to McKinsey & Company, “companies ranking in the top quartile of executive board diversity, ROEs [returns on equity] were 53 percent higher, on average, than they were for those in the bottom quartile. At the same time, EBIT margins [earnings before interest and taxes divided by net revenue] at the most diverse companies were 14 percent higher, on average, than those of the least diverse companies³.”

In the same vein, Credit Suisse’s analysis⁴ of financial performance of 2360 companies globally over a period of six years revealed that, from an investor’s perspective “it would on average have

² Deloitte. Consumer Business Predictions & Priorities, 2012.

³ Is there a payoff from top-team diversity? Thomas Barta, Markus Kleiner, and Tilo Neumann. McKinsey & Company, April 2012.

⁴ Gender diversity and corporate performance. Credit Suisse, 2012.

been better to have invested in corporates with women on their management boards than in those without.” They also note that companies with one or more women on the board tended to have “higher average returns on equity, lower gearing, better average growth and higher price/book value multiples.”

While it is difficult to demonstrate a causal relationship between board diversity and company performance, there is reason to believe that certain factors may be at work that contribute to a company’s success. There is academic support for the idea that diversity improves decision-making by fostering creativity and innovative problem-solving—effectively reducing the risk of groupthink (a breakdown in group decision-making whereby individuals succumb to the illusion of invulnerability, favouring minimisation of conflict over critical assessment of issues).

Stanford academics Deborah Rhode and Amanda Packel⁵ propose three main justifications for the role of diversity in improving decision-making. First, the inclusion of individuals with different strengths or abilities ensures a fairer representation of capabilities that may prove valuable to the discussion.

Second, diversity can have a positive contribution by generating cognitive conflict—differing opinions, knowledge, and perspectives—“that result in a more thorough consideration of a wide range of interpretation, alternatives, and consequences⁶.”

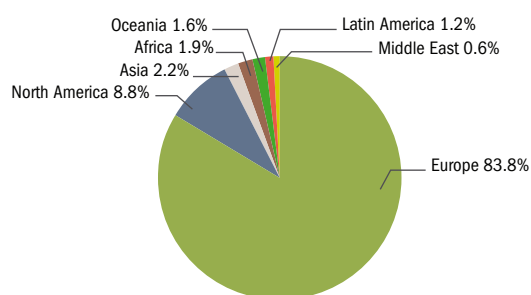
Third, the presence of visibly diverse members enhances a group’s ability to handle conflict by signaling ahead of time that differences of opinion are likely. This may improve the board’s capacity to challenge the CEO when needed.

Diversity among the top 50 European companies

Through our research, we set out to examine company reported data around board and executive management diversity for the **top 50 European companies** by market capitalisation, covering **692 board members** and **431 executives**. At present time, the two most reported and comparable measures of company board diversity are nationality and gender.

Using nationality as a key proxy for diversity, we found that **66% of the boards of the top European companies are dominated (>50%) by a single nationality**. Broadly, European nationals make up **84% of board directors** and **76% of senior executives**. Strikingly, only **5.6% of board members are nationals from an emerging market**. That figure rises to **9.5% for senior executives**. The countries most represented at these firms’ boards are: **Germany (20%), France (19%), United Kingdom (18%), Spain (8%) and the United States (7%)**.

Figure 3: Geographic origin of top European companies’ boards



Source: AXA Investment Managers as at December 2012.

⁵ Diversity on corporate boards: how much difference does difference make? Rock Center for Corporate Governance at Stanford Law School, September 2010.

⁶ Rhode & Packel, 2010.

Overall, 25 out of 50 companies have at least one board member from an emerging economy. Fifteen of the 50 companies have at least one senior executive from an emerging economy.

It is interesting to put this in context of the firms' worldwide activities. Each of these companies has sufficient size to be considered a global player given its workforce, supply chain, and client base.

For more than half of the companies, emerging markets account for at least 20% of total revenues. Many companies without a significant exposure at present have stated that at least one emerging market (mostly Asia) is of high importance in their strategy for the future.

Figure 4 shows this emerging market gap at the board level. Looking at the proportion of company revenues coming from outside Europe compared to the proportion of non-European board members reveals a varied company landscape.

Whereas a number of companies show reasonable balance in terms of geographic sources of revenues and board nationalities, it is the extreme examples that are most telling. The bottom of Figure 4 highlights 15 companies with boards that are at least 90% European yet source more than one third of their revenues from outside Europe.

This may raise a flag, particularly when the lion's share of a firm's revenues is earned abroad and the board composition does not reflect this global orientation.

Figure 4: Board and company revenues ex-Europe



Source: AXA Investment Managers, Cheuvreux Kepler, as at December 2012. 49 of the 50 companies disclosed the reported information.

Transatlantic boardrooms

European companies do not appear to have any qualms about appointing directors from North America to their boards: 62% of companies have at least one North American director. Of the largest European firms, pharmaceutical companies show the strongest transatlantic ties, with 2 board directors on average from North America—a large market which generates more than 20% of total revenues for three firms (Bayer, GlaxoSmithKline, Novartis) and a majority of total revenues for the remainder (AstraZeneca, Novo Nordisk, Roche and Sanofi).

A few company boards showed strong nationality clustering. Figure 5 identifies the 3 firms in which the main board consisted of nationals from a single country. These companies have the greatest opportunity—and perhaps greatest need—to integrate diversity into board succession planning.

Figure 5: Single nationality company boards

Company	Sector	Largest revenue markets	Board
BBVA	Banks	Latin America (50%) Spain (30%)	100% Spanish
H&M	General Retailers	Europe (32%) US (21%)	100% Swedish
ENI	Integrated Oil & Gas	Italy (30%) Europe (30%)	100% Italian

Source: AXA Investment Managers, Kepler Cheuvreux as at December 2012.

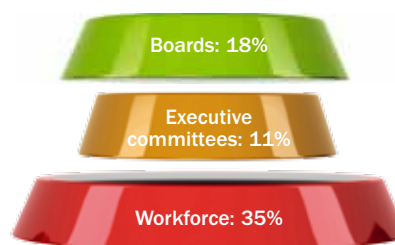
With the rise of emerging economies and a push for greater gender balance in the workforce, boardrooms are set to look dramatically different in the future

Within the top 50 European companies that we studied, **women account for 18% of board directors, 11% of senior executives and 35% of employees. Thirteen of the 50 companies have no female senior executive. None of the fifty firms has a female CEO at the time of writing.**

It is clear that there will in future be a greater demand for women directors. Main boards typically draw from the pool of senior executives in the corporate realm

to fill board director positions. Careful analysis of the proportion of women in the workforce reveals an *hourglass effect*: gender balance is high at the bottom of organisations, decreasing when going up the hierarchy towards senior management, but increasing again at board level, as shown in Figure 6.

Figure 6: The hourglass effect



Source: AXA Investment Managers, Kepler Cheuvreux as at December 2012. 38 of the 50 companies disclosed the reported information.

This lack of female senior managers today may create a bottleneck for companies looking to attract women board directors in the future. In some ways, this bottleneck is driving the ongoing push from shareholders, activists and regulators for greater gender balance in the boardroom. Companies are starting to meet this challenge by including workforce gender diversity targets, with leading companies disclosing details of their commitment and setting measurable targets aimed at improving female representation at senior executive level.

In light of this situation, investors may want to ask companies for more disclosure on plans to improve gender balance at a company, especially at the executive level. Of the fifty companies analysed, 95% disclose the proportion of women on the board. That number drops to 80% when looking at the proportion of women in senior management and in the workforce overall.

Conclusion

Given the evidence of a link between boardroom diversity and company performance, it is no surprise that shareholders increasingly include diversity as an agenda item in their discussion with companies. At AXA Investment Managers, diversity is already one of many important topics on our engagement agenda that drives the active stewardship activities we conduct on behalf of clients.

In the course of researching this paper, we engaged with 20 companies about their diversity practices and completed detailed profiles of all EURO STOXX 50 companies for use in ongoing work. Many companies acknowledged the need to further foster diversity. In several cases, leading companies shared with us their successes in improving diversity - emphasising how it enriched discussions across their firms at many levels.

Over the past decades, large European companies have evolved by business necessity from regional to global players. The prominence of North Americans in boards of many - though not all - European companies today attests to how diversity and business success can be aligned. More change is afoot. With the rise of emerging economies and a push for greater gender balance in the workforce, boardrooms are set to look dramatically different in the future.

Appendix

Diversity statistics for top 50 European companies (alphabetical)

N°	Name	ICB sector name	Market cap in EUR bn	% revenues outside Europe	% Board directors from outside Europe	% Women on Board	% Women in workforce
1	ABB LTD-REG	Industrial Engineering	36 518	20%	38%	13%	n/d
2	ALLIANZ SE-REG	Nonlife Insurance	38 031	20%	0%	25%	52%
3	ANGLO AMERICAN PLC	Mining	41 615	73%	50%	9%	15%
4	ANHEUSER-BUSCH INBEV NV	Beverages	74 867	85%	45%	0%	20%
5	ASTRAZENECA PLC	Pharmaceuticals & Biotechnology	46 710	71%	8%	25%	51%
6	BANCO BILBAO VIZCAYA ARGENTA	Banks	33 116	60%	0%	14%	52%
7	BANCO SANTANDER SA	Banks	54 562	49%	6%	19%	54%
8	BARCLAYS PLC	Banks	38170	32%	23%	15%	52%
9	BASF SE	Chemicals	55 063	27%	0%	8%	24%
10	BAYER AG-REG	Chemicals	43 812	62%	5%	15%	35%
11	BAYERISCHE MOTOREN WERKE AG	Automobiles & Parts	41 059	51%	5%	10%	16%
12	BG GROUP PLC	Oil & Gas Producers	56 823	70%	7%	14%	28%
13	BHP BILLITON PLC	Mining	151 970	87%	100%	15%	n/d
14	BNP PARIBAS	Banks	39 046	20%	0%	32%	53%
15	BP PLC	Oil & Gas Producers	103 709	n/d	47%	13%	n/d
16	BRITISH AMERICAN TOBACCO PLC	Tobacco	69 411	77%	25%	23%	n/d
17	DAIMLER AG-REGISTERED SHARES	Automobiles & Parts	44 973	44%	15%	10%	14%
18	DEUTSCHE TELEKOM AG-REG	Mobile Telecommunications	37 721	37%	6%	30%	25%
19	DIAGEO PLC	Beverages	42 332	68%	43%	40%	35%
20	E.ON AG	Gas, Water & Multiutilities	32 436	1%	0%	9%	28%
21	EDF	Electricity	31 727	11%	0%	11%	25

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N°	Name	ICB sector name	Market cap in EUR bn	% revenues outside Europe	% Board directors from outside Europe	% Women on Board	% Women in workforce
22	ENI SPA	Oil & Gas Producers	67 450	21%	0%	0%	17%
23	FRANCE TELECOM SA	Fixed Line Telecommunications	30 052	19%	0%	33%	37%
24	GDF SUEZ	Gas, Water & Multiutilities	46 337	20%	5%	22%	25%
25	GLAXOSMITHKLINE PLC	Pharmaceuticals & Biotechnolog	86 051	74%	36%	33%	n/d
26	HENNES & MAURITZ AB-B SHS	General Retailers	40 970	34%	0%	58%	80%
27	HSBC HOLDINGS PLC	Banks	113 233	68%	35%	25%	61%
28	INDITEX	General Retailers	41 763	48%	0%	22%	80%
29	L'OREAL	Personal Goods	49 072	62%	0%	29%	67%
30	LVMH MOET HENNESSY LOUIS VUI	Personal Goods	61 725	70%	12%	18%	75%
31	NESTLE SA-REG	Food Producers	145 771	69%	21%	23%	33%
32	NOVARTIS AG-REG	Pharmaceuticals & Biotechnolog	113 759	63%	42%	17%	n/d
33	NOVO NORDISK A/S-B	Pharmaceuticals & Biotechnolog	51 414	61%	8%	17%	n/d
34	RIO TINTO PLC	Mining	88 527	87%	69%	17%	18%
35	ROCHE HOLDING AG-GENUSSSCHEIN	Pharmaceuticals & Biotechnolog	113 289	65%	21%	14%	46%
36	ROYAL BANK OF SCOTLAND GROUP	Banks	35 344	25%	33%	27%	53%
37	ROYAL DUTCH SHELL PLC-A SHS	Oil & Gas Producers	170 581	60%	17%	15%	n/d
38	SABMILLER PLC	Beverages	45 863	81%	56%	19%	19%
39	SANOFI	Pharmaceuticals & Biotechnolog	75 668	65%	14%	20%	46%
40	SAP AG	Software & Computer Services	56 093	51%	0%	13%	30%
41	SIEMENS AG-REG	General Industrials	65 987	47%	5%	20%	25%
42	STANDARD CHARTERED PLC	Banks	43 924	90%	24%	14%	46%

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N°	Name	ICB sector name	Market cap in EUR bn	% revenues outside Europe	% Board directors from outside Europe	% Women on Board	% Women in workforce
43	STATOIL ASA	Oil & Gas Producers	61 463	10%	10%	36%	31%
44	TELEFONICA SA	Fixed Line Telecommunications	60 404	48%	11%	6%	37%
45	TESCO PLC	Food & Drug Retailers	30 491	18%	10%	29%	n/d
46	TOTAL SA	Oil & Gas Producers	94 704	33%	7%	31%	30%
47	UBS AG-REG	Banks	39 742	48%	25%	25%	37%
48	UNILEVER PLC	Food Producers	75 201	74%	42%	25%	n/d
49	VODAFONE GROUP PLC	Mobile Telecommunications	102 879	30%	15%	17%	n/d
50	VOLKSWAGEN AG	Automobiles & Parts	59 891	34%	10%	15%	15%

Source: AXA Investment Managers, Kepler Cheuvreux as at December 2012. Note: n/d = not disclosed.

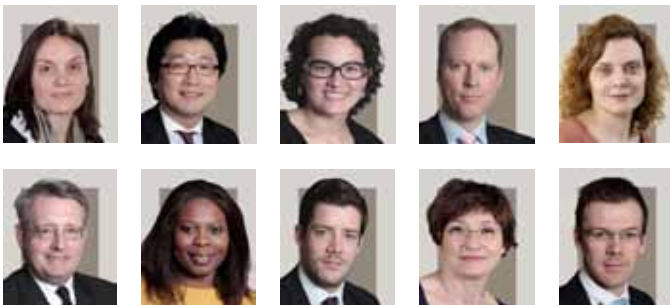
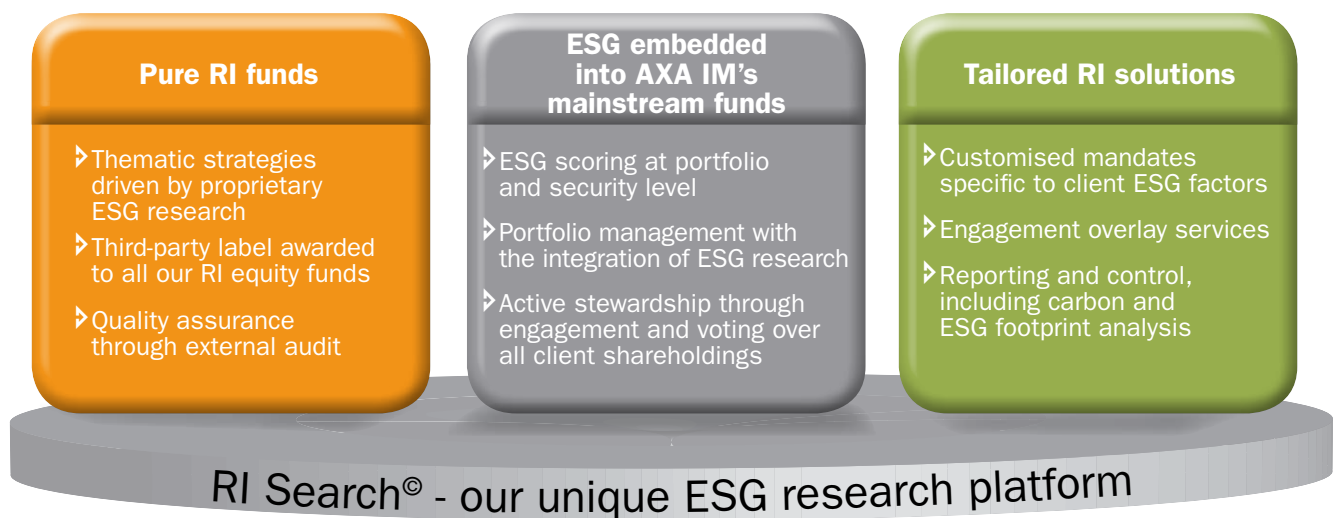
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