Corporate Governance and Gender Equality: A Study of Comply-or-Explain Disclosure Regulation

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ABSTRACT

In 2020, the Nasdaq Stock Market filed a proposal with the U.S. Securities and Exchange Commission seeking permission to adopt a board diversity-related disclosure requirement for its listed companies. In 2021, the SEC approved the proposal, thus entrenching Nasdaq's position as the most significant stock exchange to date to mandate listing rules that reflect the intention of diversifying corporate boardrooms. Nasdaq's movement into the diversity space is not the first attempt to address homogeneous boards in the U.S. In 2009, the SEC adopted a rule requiring publicly traded firms to report on whether they consider diversity in identifying director nominees. More recently, the state of California introduced mandated quotas. Between these two approaches—the light touch of the SEC's "pure disclosure" approach and the heavy hand of California's quota approach—Nasdaq's new listing rule reflects a principles-based philosophy that is operationalized through a "comply-or-explain" formulation. It requires listed companies to state whether they adhere to a particular standard of behavior ("comply") and, if not, they must provide reasons for their lack of compliance ("explain").

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Despite its increasing popularity, little is known about how comply-or-explain regimes work in practice. This Article attempts to fill that gap and to inform real-time policy conversations by providing lessons from the initial years of another jurisdiction's experiment with this very approach. Comply-or-explain disclosure requirements with respect to gender diversity on corporate boards have existed in Canada since 2014. We discuss the initial findings from our on-going project to analyze the effects of Canada's regulation. Our qualitative content analysis of the texts of Canadian corporate disclosures involves a four-year period and entails over 3,000 firm-year observations.

At a time when international regulators and private actors are contemplating, developing, and refining economic governance tools with the intention of diversifying corporate governance systems, comply-or-explain holds great promise. But if it is to realize its full potential, certain implementation-based issues should be considered. We show that comply-or-explain's effectiveness can be compromised when firms avoid measures that would result in enhanced organizational learning by presenting weak explanations for non-compliance. Without appropriate engagement by oversight bodies, comply-or-explain runs the risk of giving firms too much discretion to define what it means to comply and compliance, while following the letter of the law, may simply be performative.

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