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DIVERSITY MATTERS: MAKING THE MOST OF BOARD DIVERSITY

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DISCUSSION TOPICS

BOARD DIVERSITY: A BRIEF HISTORY

- Calls for increased diversity in the boardroom have amplified in recent years, but the discussion is by no means a new one.
  - Originally cast as discussions regarding board tenure, investors and corporate governance professionals have been asking questions regarding the importance of heterogeneity on boards for at least 20 years.
  - New targets and quotas adopted in Europe and Asia beginning in 2003 and picking up speed after 2010 began a wave of conversations in the U.S. regarding board diversity.
    - Since 2003, when Norway became the first country to adopt a quota for female directors of certain public companies, many other countries, including Austria, Belgium, Brazil, Finland, France, Germany, Iceland, India, Italy, Malaysia, the Netherlands, Spain, Sweden and the UK, have adopted quotas or targets.

The board of Statoil, one of Norway's largest companies, meets the country's high 40% quota.

BOARD DIVERSITY: A BRIEF HISTORY
Continued

- Around the same time, a series of studies on gender diversity and corporate performance was released in the U.S.:
  - McKinsey's 2007 study, "Women Matter" concluded that there was a positive correlation between meaningful gender diversity at board and top management levels and higher corporate performance among companies in several Western European countries.
  - Credit Suisse's Research Institute's August 2012 study, "Gender Diversity and Corporate Performance" looked at the impact of gender diversity on corporate leadership from a global perspective.
    - The study concluded companies with at least one woman on the board outperformed in terms of share price performance those with no women on the board over the course of the six years between the end of 2005 and the end of 2011, with the majority of the outperformance occurring during times of increased volatility and deteriorating markets.
  - In 2013, Catalyst released its study "Why Diversity Matters," which summarized the findings of several earlier studies that found that companies with the most women board directors, particularly those with three or more women directors, had better financial performance than those with the fewest women board directors.
  - In 2015, McKinsey published "Diversity Matters," which reached similar conclusions to its 2007 study with respect to gender, ethnic and sexual orientation diversity among organizations in the UK, Canada, Latin America and the U.S.
  - McKinsey's 2018 study reinforced the link between diversity and company financial performance.

THE TIPPING POINT

Why is Board Diversity a Hot Topic Now?

2017 represented a watershed moment in the U.S., not only for board gender diversity, but for gender dynamics in general

March 2016: State Street launches its "Gender Diversity Index"

January 2017: Women's March

February – December 2017: Gender-based scandals rock tech industry

March 2017: State Street issues "Guidance on Enhancing Gender Diversity on Boards"

March 2017: BlackRock indicates it plans to hold nom/gov committees accountable for a failure to make progress on board diversity

August 2017: Vanguard issues its Investment Stewardship 2017 Annual Report, indicating that board diversity is a priority

August 2017: CalPERS submits 500 letters to companies that lack gender diversity

September 2017: NYC Comptroller announces "Boardroom Accountability Project 2.0" with a focus on board diversity

October 2017: #MeToo movement begins

November 2017: ISS and Glass Lewis issue new policies, including statements on diversity

2017

2018

2017: State Street makes good on its threat to vote against the nom/gov chair where boards fall short of its gender diversity expectations and votes against the re-election of directors at 400 companies

CORRELATION VS. CAUSATION

Does Diversity Improve Corporate Performance?

- While studies by McKinsey, Catalyst, Credit Suisse and Thomson Reuters indicate that there is a positive correlation between diversity in the boardroom and corporate performance, there are a few studies that suggest that there is no correlation.
  - A 2017 Wharton article indicated that peer-reviewed studies suggest that companies with women on the board do not perform better or worse than companies without women on the board.
  - The 2009 article "Women in the Boardroom and Their Impact on Governance and Performance" by Renee Adams and Daniel Ferreira in the Elsevier Journal of Financial Economics suggested that the average effect of gender diversity on company performance is negative.
- In addition, the 2005 article "Additions to Corporate Boards: The Effect of Gender" by Kathleen Farrell and Philip Hersch in the Elsevier Journal of Financial Economics concluded that although better performing companies tend to have more women on the board, there is no evidence that more gender diverse boards actually generate better performance.
- Despite these few studies, many investors are convinced that having diversity on boards helps eliminate groupthink, reduces financial restatements and improves overall performance, and each year additional studies support this conclusion.

TOP INVESTORS' VIEWS

Does Diversity Improve Corporate Performance?

BlackRock

"Diverse boards … make better decisions."

- In its Investment Stewardship Engagement Priorities for 2017 and 2018, BlackRock indicated that, where a board fails to make progress with respect to the diversity of its membership, it will hold nom/gov committees accountable for an apparent lack of commitment to board effectiveness.
- In his 2018 letter to CEOs, Larry Fink stated that diverse boards are "less likely to succumb to groupthink…[a]nd are better able to identify opportunities that promote long-term growth."

State Street

"Companies with greater gender diversity have stronger financial performance."

- In its Guidance on Enhancing Gender Diversity on Boards, SSGA states that it believes "board diversity enhances board quality" and that as a starting point, "boards should have at least some independent female directors."
- For boards that lack diversity, SSGA will vote against the chair of a board's nom/gov committee or the board leader if the company fails to take action to increase the number of women on the board despite SSGA's efforts to engage with the company.

Vanguard

"Greater gender diversity … can lead to better company performance and governance."

- In its Investment Stewardship 2017 Annual Report, Vanguard stated that "gender diversity has emerged as one dimension on which there is compelling support for positive effects on shareholder value."
- In providing examples of discussions it has had on the subject, Vanguard noted one company that "[d]espite verbally endorsing gender diversity, [had] resisted specifying a strategy or making a commitment to achieve it," and continued to "rel[y] solely on recommendations from current directors" in seeking new directors.

USING DIVERSITY

Why Having the "Diversity" Conversation is Important

- A 2017 board diversity survey[(1)] by Deloitte reveals that while executives believe in the benefits of diversity among board members, many have a difficult time defining it and developing practices for promoting it.

>90%

of respondents

believed that greater board diversity will enable the organization to improve its ability to innovate and manage disruption and overall business performance…

and yet…

Boards still rely on traditional candidate criteria,

87% of respondents see current or retired CEOs as the most effective board members

… do not plan for diversity, and

46% of organizations with succession plans do not have a specific process for recruiting diverse candidates

…rely on current directors' recommendations.

84% of large-cap and 90 percent of mid-cap organizations most often rely on current directors' recommendations of candidates

(1) The *Seeing is Believing 2017 Board Diversity Survey* was conducted in spring 2017 among 300 board members and C-suite executives at U.S. companies with at least $50 million in annual revenue and at least 1,000 employees.

USING DIVERSITY TO SUPPORT STRATEGY

Productive Disruption and Enhanced Strategy

- Companies that effectively use board and upper management diversity to enhance corporate strategy are likely to consider:
  1. Adopting approaches to board communications and meetings that facilitate robust discussions in which all members actively participate;
  2. Providing an opportunity at least annually for the board and upper management to discuss corporate culture, including with respect to matters of diversity; and
  3. Identifying ways for diverse directors to make unique contributions to the board's oversight of corporate strategy.

Case Study[(1)]: When Lou Gerstner took the helm of IBM in 1993, few of the company's executives would have identified diversity as an area of focus, but Gerstner felt his executive team didn't reflect the diversity of the market for talent or IBM's customers and employees. To rectify the imbalance, in 1995 Gerstner launched a diversity task-force initiative that became a cornerstone of IBM's HR strategy. The company also began diversifying its board membership in the late 90s, and today it is a positive example of both gender and ethnic board diversity. The initiative coupled with diverse oversight has enabled the company to grow its own diverse upper management over the years.

(1) Harvard Business Review, "Diversity as Strategy," David Thomas (Sept. 2004); with updates.

USING DIVERSITY TO MITIGATE RISK

Employment Risk and #MeToo

- While most companies have policies and practices in place to support a workplace free from discrimination, sexual harassment and other misconduct, the #MeToo movement has raised questions about the board's oversight of employment and labor-related risks.
- The #MeToo movement may provide another reason for companies to consider refreshing board membership and recruiting new diverse members.
- In the #MeToo environment, companies that effectively use board and upper management diversity to mitigate employment and labor risk will consider:

1. Making sure the board is well-informed on the company's diversity, sensitivity and anti-harassment training, as well as any widespread allegations or allegations against members of management;
2. Having clear policies on when and how matters are escalated to the board;
3. Whether to reflect the importance of compliance when addressing employment contracts and compensatory incentives; and
4. Whether an independent board committee should be charged with oversight of internal investigations.

USING DIVERSITY TO ENHANCE A CULTURE OF COMPLIANCE

- Corporate culture influences every part of a company and plays a significant role in corporate compliance, strategy and performance.
- While the role that directors can play in shaping corporate culture may be narrow, companies that effectively use board and upper management diversity to enhance a culture of compliance will consider:

1. Adopting board policies that encourage directors to think creatively about (a) the process by which they select the CEO and other members of management, (b) the issues considered when conducting performance reviews and compensating management and (c) succession planning;
2. Providing opportunities for directors to “see and be seen” throughout the organization, including opportunities for directors to speak directly with employees;
3. Creating a culture dashboard with internal and external metrics (e.g., employee hotline calls, management performance results, health and safety, customer relations, compliance) to assess and monitor company culture; and
4. Creating a separate culture team that meets at least annually with the independent directors.

UTILIZING YOUR CURRENT BOARD COMPOSITION

- Boards that are not currently "diverse" can still create some of the strengths frequently associated with diverse boards by implementing the following practices:
  - Review the board communication processes for opportunities to encourage healthy debate;
  - Add a session on diversity and culture to the board's education session; and
  - Add questions regarding the company's approach to board and upper management diversity to the board and committee evaluation process.
- For companies with boards that are not "diverse," stretching the concept of diversity in corporate disclosure (e.g., diversity of thought or experience), may ultimately backfire.
- What to do if your board is not particularly diverse and you receive pressure from investors?
  - Consider how to enhance your current governance practices and disclosure;
  - Consider whether to adopt a diversity policy; and
  - Consider whether to work with an organization focused on matching boards with diverse candidates.

ENHANCING YOUR DISCLOSURES

1. Consider providing more disclosure on directors' skills and qualifications, and linking those descriptions to their biographies and committee service with icons.
   - Undertaking a proxy statement refresh does not have to be overwhelming, and thoughtful use of graphics and images can help you tell the company's story.
2. Emphasize the strengths your board has (e.g., significant independence, regular refreshment/mix of tenures).
   - Instead of hiding a lack of diversity, emphasize the strengths your board has.
3. Highlight good governance practices (e.g., independent chair or lead director, majority resignation policy, ownership guidelines, board evaluations, anti-hedging/pledging policies, term/tenure/age limits, continuing education).
   - A "Dos" and "Don't's" table is a great way to reduce the volume of disclosure while still drawing the readers' attention to good governance practices.
4. Identify stockholder rights (e.g., annual elections, special meeting, written consent, proxy access).
5. Outline opportunities for stockholder feedback (e.g., communications with the board, annual stockholder engagement efforts).
   - If the company has yet to adopt an annual stockholder engagement approach, consider doing so.

BOARD DIVERSITY POLICIES

- While the adoption of a board diversity policy had been unusual in prior years, a sea change has occurred in 2017 and 2018, and more companies are adopting board diversity policies. Such a policy could take any of several approaches:
  - **The search/assessment approach**: The company agrees to periodically assess the board's diversity and/or commence a search or engage a search firm in commencing a search for diverse candidates.
  - **The "Rooney Rule" approach**: The company agrees to identify and/or interview at least one or more diverse candidates for each board vacancy.
  - **The percentage approach**: The company agrees to maintain a certain percentage of diverse directors on the board.
  - **The deadline approach**: The company agrees to appoint a certain number or percentage of diverse directors within a specified period.
- In adopting a board diversity policy, companies should consider:
  - How to define "diversity" for the purposes of meeting any specified number or percentage;
  - Whether to limit implementation of the policy to the board refreshment process; and
  - Whether to allow the board to waive the policy in certain circumstances.

ORGANIZATIONS FOCUSED ON ASSISTING BOARDS IN IDENTIFYING DIVERSE CANDIDATES

- ***Board Ready Women***. This Deloitte initiative provides senior women executives with an invitation-only program held over several months, which is focused on laying the groundwork for their future placements on public and private company boards.

- ***WomenCorporateDirectors***. This foundation seeks to inspire and educate female board directors and serves as an advocate for greater diversity on corporate boards. The organization also assists boards looking for qualified women candidates.

- ***Directors' Academy***. This organization focuses on identifying, developing and advancing the next generation of diverse board members. The organization aims to build a pipeline of highly credentialed prospective board members from diverse backgrounds, experiences, ethnicities and genders.

- ***The Executive Leadership Council***. This organization is focused on the development of global black leaders. The organization's Corporate Board Initiative enhances the preparedness of black executives for service on corporate boards by building awareness, improving readiness and enhancing the visibility of its members.

THANK YOU

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