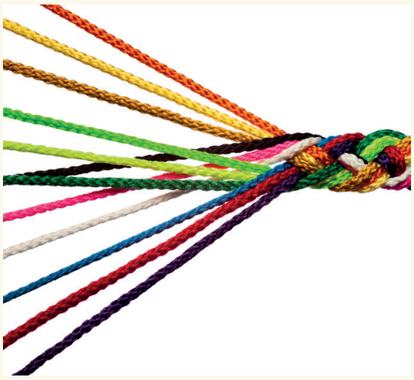
THE TRUSTED ADVISOR

THE TRUSTED ADVISOR is our firm's regular publication, featuring not only articles and insights derived from our project work but also guest posts and interviews with leading business figures.
They offer food-for-thought and practical advice on a variety of key topics in the leadership, ownership advisory, governance and strategy domains.

TTA 01-2018| WHY DIVERSITY IN THE BOARDROOM MATTERS



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No pain, no gain!

The critical role of diversity on Boards

by Carolyn Lutz and Andreas von Spechtt

Diversity on Boards is very important. It's a proven case – and there should no longer be an open question as to why. As Michael Hathorn pointed out in our interview with him for this edition of "The Trusted Advisor", there are a large number of studies around from recent years which confirm a straightforward and compelling business case. Companies with (gender-) diverse Boards make better decisions and produce higher returns. Board success and competence includes diversity as an essential element rather than as an afterthought or as a concession to special interests. Moreover, CEOs who have crafted a diverse and effective Board are respected as secure, modern leaders who 'get it'.

While the business case for Board diversity gains acceptance, Board composition is only slowly evolving along a continuum, from homogenous to diverse. On the one hand, the homogenous 'Board of the past' that has the requisite 'business leader' names, is relatively easy to manage, and complies with the general direction that the CEO would like to take the company. Contrast that to a high-performing diverse Board that listens and challenges, and which by virtue of the age, ethnic or gender diversity of the individual Board members offers a breadth and depth of insight, perspective, and experience that will help the Board question its assumptions and make better decisions. The Business Roundtable, a highly influential group of corporate executives, recently released a statement that explicitly links higher Board diversity with better Board performance in the two key areas of oversight and value creation.

Diversity goes well beyond just male and female – it can also manifest itself in individuals with different skills, life experiences, and philosophies. The whole point of a diverse Board is to avoid 'male, pale, and stale'; to get a fresh view of challenges and opportunities, and to use discussion, different mind-sets and push-back to arrive at the best solution for the business. Having a broad range of collective attributes, rather than overlapping redundant competencies, positions the Board to better fulfil its governance and strategic oversight mandates. Hence, in our view it is a strategic risk, and a liability, to have an overly homogenous Board.

Most organisations have a highly diverse customer base – one would think it must make perfect sense to aspire diverse points of view represented in the most important discussions and decision making around the organisations' future goods and services. Great ideas can come from disrupting 'the way things have always been done' – innovations catering to previously unknown or underserved markets. Multiple-perspective analysis of problems can change the Boardroom dynamics and is more likely to yield high-quality decisions than decisions made under a 'groupthink' environment. Of course, the latter is probably more comfortable, less challenging and less stretching.

The company that has a diverse Board can also enhance its attractiveness to its (hopefully diverse) workforce by sending a strong signal that developing women and minorities is important to the company. This holds equally true in attracting new talent from outside the company. Given the war for talent, no company can afford to send the signal that they do not value diverse talent.

A diverse Board will certainly enhance the organisation's reputation vis-à-vis investors. Institutional investors have taken Board diversity into account as a factor for investment evaluation since a number of academic research papers show positive correlation between firm value and Board diversity; institutional investors are also placing greater emphasis on corporate social responsibility. Board diversity can therefore, to a certain extent, improve investor relations.

A simple and common measure to promote heterogeneity in the Boardroom – commonly known as gender diversity – is to include female representation on the Board. While this sounds like an easily implemented and logical solution, particularly for organisations whose customer base is predominantly female, in practice many boards are still 100 % male, or have just one token woman.

Reasons for failure to hire diversity candidates are numerous: it starts with a common resistance to change. In Board recruiting processes, we are often confronted with a 'wish-list' prerequisite for a new NED to have served as a successful CEO. This becomes a bit of a Catch-22 and automatically narrows the list of suitable diversity candidates. Other reasons can be cultural; in male-dominated countries women are often denied or discouraged from the educational opportunities, professional development, networks, and mentoring that would equip them to one day add value on a Board. Societal norms have thus made women less likely than men to raise their hands for certain professional challenges.

Around the world, progress for gender diversity on Boards is at best mixed; at the current rate of 'improvement' it has been calculated that we will not reach gender parity until the next millennium. However, Board diversity can be promoted by a number of methods: through imposing quotas on the Board; or by enhancing disclosures using the 'comply or explain' approach with the hope that companies will enhance their diversity to avoid tarnishing their company brand.

Imposing quotas refers to the mandatory requirement in appointing a minimum percentage of female directors. Since 2006, each listed company in Norway has had to ensure that women fill at least 40 % of directorship positions. In 2016, Norway had 45.4 % female NEDs; and 34 % foreigners, which can also be seen as 'diverse' since this implies a different language and culture. Most European countries have implemented similar mandatory requirements for gender diversity (with the exception of Switzerland, which has 'recommendations'). In 2016 Germany, women held 26.4 % of NED roles at companies subject to quotas. Interestingly, 60 % of companies not subject to quotas in Germany had 30 % or more women on their Boards.

Another measure to enhance Board diversity besides quotas is through transparency and disclosure. Companies, under corporate governance codes, are required to disclose their diversity policy in appointing directors so that investors and stakeholders can make proper evaluation. Those who fail to implement such measures have to explain their non-compliance in the corporate governance report or equivalent. The Corporate Governance Code of the United Kingdom (2010), for example, stipulates that companies are required to incorporate diversity as a consideration in making Board appointments, to describe the Board's policy on diversity in their annual report, and to report progress in achieving the objectives of that policy. In 2017, the largest 100 companies listed on the FTSE had 33.3 % female non-executive directors, and 24.5 % non-nationals. A 2017 Cranfield study interviewing experienced Board evaluators concluded that "(the evaluators) were extremely clear about the considerable benefits of a critical mass of diversity in the Boardroom (often defined as three 'diverse' individuals)".

Switzerland, with no female quota requirement, is slowly catching up on gender diversity on Boards. In 2017, in the 20 companies comprising the Swiss Market Index, 22.2 % of directors are women – and 37 % of NEDs appointed in the past 12 months were women. The country scores among the highest for international Boards, with 61 % being non-nationals.

In order to promote diversity in Board composition, Boards should become more familiar with director search approaches to identify qualified candidates that would not otherwise come to the attention of the nominating committee. For us it is not surprising that we are involved in director searches where Chairmen specifically want us to identify candidates who operate beyond their typical field of view. We still need even more Chairmen to muster the same courage!

Only the bold will survive

Why age diversity is an issue Boards should consider

by Anthony Harling and Dr. Christian Bühring-Uhle

For some time diversity has commonly been identified with the gender balance on company Boards. Over the past 20 years, there has been a concerted effort by companies to bring more women onto the Board and the positive effects of this trend are well documented. However, this is not the only facet of diversity. A truly balanced Board will more accurately reflect the wider population of the outside world, not only in terms of gender, but also in terms of age, ethnic background, national origin, and regional variation. Companies are more aware of gender diversity today and there is still work to be done in this regard. Age diversity could be the next hot topic, considering that Boards actually are quite “old”, and “ageing”: the median age on Boards of S&P 500 companies grew from 61 in 2005 to 63 in 2015.

There has been relatively little research on the impact of age diversity on Board performance, so there is perhaps not enough evidence to draw any firm conclusions. A recent study of companies on the OMX Stockholm, however, did look beyond the issue of gender diversity and focussed on the impact of age diversity. The conclusion that “age diversity significantly affects firm performance as measured by ROA” is worthy of note.

The increasing focus on corporate governance in recent years has been accompanied by increasing criticism of the age-old practice of “male, domestic, old” (“zu männlich, zu deutsch, zu alt” as the Sueddeutsche Zeitung describes it). The rules have changed and forward-thinking companies are taking the lead in bringing on board a more diverse population of Board members in the hope that this will change the way that the company thinks about current issues.

What are companies doing? Why does age diversity matter? Some large US companies have been quite bold in their approach. The US retailer Macy’s appointed a 45 year-old EVP from Starbucks to their board in 2014. Annie Young-Scrivner had a successful track record in her prior general management roles with PepsiCo and Starbucks when she joined the Board of Macy’s. Nevertheless, the appointment of someone with no prior CEO or Board experience elsewhere represents a significant departure for such a large, high-profile business. The success of this appointment is indicated by the fact that Macy’s went on to appoint 42 year-old Leslie Hale, executive vice president, chief financial officer and treasurer of RLJ Lodging Trust, to the Board in 2015. Starbucks appointed Clara Shih with 29 in 2011. Closer to home we have the example of Dr Christina Reuter appointed to the Supervisory Board of Kion Group AG in 2016, at age 30. Younger, talented executives with no prior Board experience are starting to make their mark.

What could be behind these moves? There could be many reasons.

Firstly, as with any other Board appointment, it is clear that any external candidate will need to bring the requisite skills, insight and capability that any appointment at this level demands. It is not enough to be younger than the average age of existing Board members, the candidate has to be exceptional as well.

The move towards a more diverse Board profile can give the company advantages in many areas. Shareholders may be interested in the novelty factor for a while, but it is the overall financial performance of the business that matters most in the long term. It is quite likely that a younger, more diverse profile brings the company greater insight into consumer behaviour. And it will it help the other Board members to better appreciate the impact of technology and social media on their future business. It is also bound to lead company Boards to demanding a greater degree of innovation, a greater pace of change. Externally companies are facing an ever-changing and fast-moving world in which the old certainties are being challenged by new, agile competitors and new realities. It is not enough simply to react to these factors; companies need to be pro-active in anticipating and preparing for a different world. Only the bold will survive.

What are the obstacles to greater age diversity on Boards? What is there to stop this happening? Age diversity in the Boardroom is not going to be a matter of legislation in the short term. There will be some companies who see this as an urgent priority, others who are not so concerned. In practice it will depend on the will of the Board as a whole. If current Board members are concerned for fear of “rocking the boat”, then change is less likely to come about. Will younger Board members be able to balance the requirements of external Board membership with the demands of their current executive role? Will they be taken sufficiently seriously by their Board colleagues? The experience of Macy’s and other Boards suggests that these issues can be overcome. The more challenging question is where these people can be found.

Unless they have worked with someone before in a prior role, no one knows how a new colleague or Board member is likely to perform. Especially if the potential Board member has no prior experience of acting in this capacity. The requirement, therefore, must be clearly understood beforehand. The Board may also need to consider the topic of governance more broadly in order to evaluate this possibility. At a minimum, this is something that current Board members will need to think about and discuss.

What is it that we should be doing today that will position us for success in the future? How important in the question of age diversity for us today? In our view, age diversity is not a “nice to have”, it is a matter of sustainability, even survival – and it is much more fun!

How Board diversity drives company performance

An Interview with Dr. Michael Hathorn, Professor of International Business

by Nick Harris, Felix B Waldeier and Karin Onater

AvS – International Trusted Advisors: Diversity is an intensely discussed topic in the business world. Could you tell us something about the commercial advantages for companies committed to building top teams with a high degree of diversity?

Michael Hathorn: The business case has been building for some time and is quite compelling, with a large number of studies that strongly correlate more gender diverse boards with higher performance on the typical financial metrics. The Credit Suisse Research Institute, for example, showed that companies with higher proportions of women in decision-making generate higher returns on equity and maintain a more conservative balance sheet. Other studies confirm that where women are the majority of top management, the business has higher sales growth, higher cash flow returns on investments and lower leverage. When you have only one woman on the Board, there is the risk of tokenism and the inevitable discounting of that person's views. You only overcome that effect when you get a critical mass. Firms with three or more women on their Boards produce the highest impact on corporate financial performance.

What is behind this correlation between female executives and business performance improvement?

Decision-making and internal team processes appear to be more robust when there is substantial female participation. Studies conclude that women spur a deeper debate on key issues and that gender-diverse teams come up with more innovative solutions, which is critical for company survival and strategic impact in today's very turbulent world. Furthermore, women have higher attendance rates on Boards than males do and set a new norm for their Board. As a result, male attendance rates go up as well. There are also fewer strikes and layoffs in crisis times under female leadership, measures that can be very costly for companies in the long term. Another, maybe more subtle impact of having females on Board is the improvement of corporate reputation. Many companies find themselves under a lot of pressure from their stakeholders to diversify their Boards. Consequently, a company becomes more attractive as a recruiter for female executives who appreciate a diverse approach. By doing this they gain preferential access to a much larger pool of talent. Again, these effects are not present with only one female on the Board.

If the advantages of diversity are so compelling, why do so many companies still have Boards that are monochrome?

There are a number of systemic issues that are extraordinarily difficult to overcome. First, change is difficult, and culture is persistent. There is a tendency to maintain Board recruitment processes and behaviours over time, which tend to produce very similar Board compositions. Additionally, we can observe the talent selection phenomena of “cloning”. People tend to feel more comfortable with those who are similar to them, which consequently reinforces the selection of male Board members. Another important systemic issue is that talent pipelines in organisations becomes increasingly male as the hierarchical levels increase. This results in senior talent pools that are predominantly male. However, there are enough qualified women who could rise to the top. For instance, balancing family and work is still a big barrier for women moving up the career ladder and becoming “Board ready”, but female executives usually experience a significant “work-family” challenge only over a relatively short period of their working life, perhaps 10-20% of a 40-year career. If you have identified the right talent to drive your company forward, it is worth bridging that period with creative solutions that keep female talent engaged.

Do the specific values and long-term orientation of family companies constitute an advantage in building diverse teams, compared to publicly traded companies that might operate under a lot more pressure?

The values part of this hypothesis is not consistent with my experience. I have worked with a few family companies where a commitment to patriarchal values has resulted in the less talented family member assuming a leadership position due to their gender. However, I do accept that family companies are often able to leverage a longer-term orientation toward the business as they are free from the short-term market pressures of listed companies. It is in general difficult for companies to change culture and adjust themselves to the challenges that exist in today’s world, regardless of their type. That said, I believe culture can be an important driver of strategic advantage. Google, for instance, is a listed company that adapted to the needs of its employees by offering child care, flexible working hours, leisure activities and many other benefits. Performance standards are nevertheless very high, and meritocracy seems to be a key value. Many companies equate presence with performance and do not realise that employees appreciate and become even more engaged in a flexible working environment where the quality of their work is the key metric. Companies should make use of today’s technology to increase flexibility and adjust their working environments, while continuing to focus on performance.

The “Nordic model” is often held up as the best example of a region with a gender-diverse Board landscape. What did the Scandinavian countries get right?

From the beginning, the Nordic countries aspired to develop their governance guidelines in line with global best practice. They incorporated a multi-stakeholder approach that goes far beyond just profitability. By including and holding different interest groups accountable, the issue was raised to a social level and discussed in a much more holistic way. In the case of Norway, the argument has been made that gender-diverse Boards are important for the country and for businesses alike. Using only half of the available talent pool put the country at a competitive disadvantage globally. If a Norwegian company wants to have access to its stock market, it has to make use of the entire talent pool, and this must be reflected at Board level.

Mandatory quotas are one measure used by Nordic countries to increase gender diversity. What are the arguments for and against setting gender diversity quotas for Boards, and whether those quotas should be mandatory?

I think voluntary quotas or targets are preferable as a first step to drive change, reverting to mandatory quotas if progress is insufficient. Norway actually did not strictly enforce their law regarding Board composition from the beginning but encouraged companies to comply voluntarily. Two years later, as there was little progress, the law was implemented. In a very short period of time, the Norwegian Boards of listed companies raised their Board diversity levels up to 40%. The main downside we could observe was the phenomena of “Over-Boarding”. Due to the rapid change, women were serving on many Boards in parallel and sometimes took on a little too much. However, a number of studies concluded that the consequences people feared, e.g. that companies will underperform or that female executives are not experienced enough, proved to be unwarranted.

What career advice would you share with female executives who aspire to Board positions?

Female executives first of all need to build executive experience, internationally, if possible. There is no substitute for having P&L roles and building an expertise base. Secondly, they need to question and understand their own motives for seeking Board work, and they need to be able to articulate them. It is very important for female executives to develop a broader network and actively promote their capabilities in the wider marketplace. This involves joining groups and events that may be predominantly male, and engaging in discussions with men in which they need to be able to clearly point out their accomplishments and ambitions – a rather atypical behaviour for women, which they nevertheless need to adapt in order to make significant impact in predominantly male businesses.

So far, we have talked mainly about gender diversity. Is this focus on gender warranted or should Boards be thinking in a broader, more holistic way?

In my opinion, we need to place the focus on gender balance. Females are a fundamental aspect of diversity, and they are underrepresented. By focusing on bringing more women to the Board, other types of diversity come with it: diversity of thought, mindset, experience, style, etc. However, Board recruitment always has to be driven by the needs of the Board. It is essential that companies do not approach Board diversification as a compliance exercise, but as an attempt to hire the best person for the job – which happens to be female. At the same time, we need to be aware of the need for ethnicity and nationalities on our Boards – again, not because of political correctness, but because the Board should reflect the business. If you have global operations, you need to have certain expertise with respect to your key geographies. This will increase the company's opportunity for impact in that part of the business.

We are living in times described as Volatile, Uncertain, Complex and Ambiguous (VUCA). The speed of change and the pressure for success is ever increasing. How can Boards keep up, adapt and stay relevant?

In a highly volatile environment, leadership is best exercised through vision and values, instead of elaborate strategic plans. We need to continuously question the assumptions we make and be willing to change our plans if warranted. Uncertainty and complexity require executives and Board members to connect very deeply to multiple levels in the organisation in order to take cross-functional decisions that are in service to the entire business. Finally, ambiguity is an invitation to drive innovation and break new ground. Boards need to recruit members who bring this deep expertise and are capable of operating across the business. They need team players who are fully engaged in the business, ready to lead a deep and meaningful debate. So far, I do not feel like companies are doing enough to address the challenges of a VUCA environment. Many Boards are too far removed from their business, where members are focused on their own "silos" of responsibility and expertise. When a serious challenge hits, these fault lines are very much exposed.

How do you ensure the right mix and chemistry, bringing together the best blend of backgrounds, expertise, perspectives and personalities?

First, you need to be very clear about the specific skills and knowledge that every Board member needs to bring in. That includes eliminating the extraneous criteria that may not have a significant impact, like being a former CEO – this is almost a non-criteria for me, since so many other executives demonstrate that they have gained a holistic view of the business during their career. You also need to define the role the future member will have on the Board. It might make sense for a female Board member to take on the role on the Nominations Committee, if you are trying to expand your scope of recruitment. Then you need to consider demographic data, diversity elements like age, gender, race, nationality etc., to be able to represent all parts of your business. Look at the automobile industry: It took some companies a long time to understand that women are a very important part of the decision-making process when it comes to buying a car. If they had engaged with female Board members with marketing acumen and an understanding of buyer behaviour, they never would have overlooked the role and influence of women in automobile purchasing. Prioritising your diversity needs alongside your business requirements will help to create focus and drive results. In the end, it is a talent question, not a gender question.

What are the necessary ground rules for a diverse Board to work together in a dynamic and highly effective way?

Research concludes that a great level of trust is essential for engaging in open debates and speaking one's mind. If a Board member does not participate in the decision-making, he or she will naturally have reservations and will not be committed to the decision. That again reduces accountability and ultimately has a negative impact on the results. In order to create an environment in which conflict of ideas is encouraged, it is essential to develop a team Charter or common understanding that captures the mission, guideline and expectations for the team culture and team member contributions. The most important influence however is the behaviour and interaction of the Chairperson, who needs to continuously question their own mission and performance in order to build a team that is striving to improve, reflect and incorporate everyone's ideas. A Board needs to have clear criteria for its own performance and the performance of its members and needs to regularly assess itself against these expectations.

How should that Board assessment best be done?

There is no "one size fits all" way to monitor and assess Board performance. It is important that Boards develop their own self-monitoring mechanisms for group and individual performance. That can be done with or without the help of an external advisor. For individual performance, I would always recommend a self-evaluation based on conversations with the Chair and the other Board members. The Chair then has to confirm and augment this self-evaluation and point out potential blind spots. It is amazing how many Boards have not installed a structured evaluation process because it may be perceived as somewhat negative, heavy and almost compliance-driven. But the purpose is rather to seed a culture of continuous improvement in order to become a more effective Board member and a more effective Board.

Do you have a last piece of advice on the diversity topic for Chairpersons and CEOs reading this interview?

Approach gender diversity as an opportunity to improve Board performance and to create significant additional business value – and not as an exercise in political correctness. No one else can have as significant an impact as the Chairperson and the CEO in evolving the attitude and mindset in the company to one that embraces and understands top team diversity. This is key. I have spoken with a number of Board members and Chairs who initially were very sceptical about gender diversity on their Boards. After experiencing the opportunities and impacts that a diverse Board provides, they embrace it. If all CEOs realise the benefits of a diverse team, we will not need quotas.

Michael, thank you for these insights!

Dr. Michael Hathorn is an Affiliate Professor at Arizona State University and the Thunderbird School of Global Management. In addition, he is a Partner in the area of Board Development at the International Center for Corporate Governance and teaches Leadership-Governance in the DAS program on Sustainable Business – a joint program of the University of St. Gallen and Business School Lausanne.

AvS News

Recent news and developments at AvS – International Trusted Advisors

The past months were marked not only by interesting client projects, but also by exciting developments within our firm that we are delighted to share with you in this edition of THE TRUSTED ADVISOR.

New Consultant in Bogotá

In February, Eleonora Cajiao Cabrera joined our Bogotá office. Eleonora is a Colombian qualified lawyer and a UC Berkeley trained expert in International Business. She previously worked for Unilever in various senior management positions in the Andean Region and led several international expansions before becoming active in the field of Executive Search and Human Talent Advisory. As Senior Client Partner in the Bogotá office of the global consulting firm Korn Ferry, she oversaw the Consumer Goods, Big Pharma, Government and Industrial practices for the Andean, Central American and Caribbean regions. Eleonora combines almost 30 years of leadership experience in talent consulting (search, selection, and professional development) leading companies from various industries.

Panel Discussion on “Diversity on Boards” in Geneva

In cooperation with Berenberg Bank, our Geneva office organised a panel discussion entitled “Board Walk: Where are the Women? Upgrading Boardrooms with Dynamism and Diversity”. Our consultants Carolyn Lutz and Nick Harris moderated a discussion with an expert panel: Regi Aalstad and Pauline Lindwall, two internationally experienced female Non-Executive Directors, and Dr. Michael Hathorn, Professor at the Business School Lausanne and a specialist in Board diversity (who also made himself available for an interview for this issue of the TTA). Together with numerous participants, they discussed how companies can make better use of the full talent spectrum and improve Board performance.

News from our Latin American practice

Christian Bühring-Uhle, in charge of leading and developing our Latin American practice, was named “Mentor of the Month” by Endeavor Colombia in March, a leading movement for high-impact entrepreneurship around the world. In addition, Christian was also honoured by the German Colombian Chamber of Commerce end of March for his three years of service on the Board.

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