No pain, no gain!

The critical role of diversity on Boards

by Carolyn Lutz and Andreas von Specht

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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!

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