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Convergence towards a Global Board Composition

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Introduction

The 2015 update to the OECD/G20 Principles of Corporate Governance reemphasised the need for inclusiveness through higher quality supervision, disclosure, and risk management. As more companies embrace these good governance principles, their boards of directors are converging towards a more diverse standard. A higher level of diversity on board of directors is becoming widely accepted as the de facto model for global businesses. The concept of board diversity has evolved over the past decade to include a balancing of skill and experience, which encompasses factors such as age, gender, background, industry, age, qualifications, etc. Increased board diversity has continuously showed by researchers to increase firm profitability. Diversity is also an issue increasingly under scrutiny by institutional investors. Ct W Investments, which has $250 billion in assets under management, have openly campaigned against the election of board members at Chipotle, Nabors, and Netflix on the basis of insufficient diversity.

This paper examines the diversity indicators among non-executive directors such as gender, nationality, independence, industry, and previous experienced at a national level for the biggest companies listed on the national stock exchange for five countries: United Kingdom, United States, China, India and South Africa. The findings show that four of the five countries are converging towards a globalised norm of diverse corporate board composition, with China as the exception. The findings show that the non-executive directors' diversity indicators vary on a country-by-country basis, but are relatively uniform within a country. These are fairly independent of industry in which the company operates.

Methodology

The five countries were selected to represent a cross section of developed and emerging economies. The country must have at least one major stock exchange, and a diversified set of companies listed on the exchange. The five countries selected were United Kingdom, United States, China, India and South Africa.

Next, the country's predominant stock exchange was identified, and the top ten largest companies by market cap size were found. The companies were codified according to industry type, number of employees, and private or state owned.

Lastly, the non-executive directors of each of the top five largest firms were manually collected from company websites. For each NED, the following data was collected: role, name, gender, nationality, industry, independent (Y/N), previously C-level (Y/N), and most recent job title. Within the category of industry, this value was assigned based on their most recent background, in conjunction with their career's work. For example, a CEO of Credit Suisse who spent his career as a general counsel for financial firms would be classified as 'financial industry'. There were seven categories of industry:

1. Telecommunications, Technology, Media
2. Natural Resources, Energy, Mining
3. Finance
4. Consulting
5. Law, Public, Academia
6. Industrials, Manufacturing, Chemicals
7. Consumer Goods, Food, Beverages

The background job was their full time employment or their last title prior to retiring or moving full time into NED positions.

Once this data collection was completed, analysis was performed on the data. Averages were taken when possible or a scale was introduced. The only category that required a scale was 'Industry Diversity'. The scale ranged from low to high, with increments of low-medium, medium, and medium-high. The score was based on how many different types of industry backgrounds were present on the board. It also took into account the size of the board: in theory, a larger board should have a more broad representation of industries.

Findings

Summary

The number of NED on a board varied slightly across countries, with no notable exceptions. South Africa had the largest number of NED, at 12 board positions on average, while India had the lowest number at 8.

The United Kingdom (UK) boasts the highest number of NED women, at 42% on average. This impressive number is 12% higher than the next highest, in the US. A large part of this increase is due to a voluntary initiative launched by the UK Government to increase female representation on boards. This successful campaign doubled the total number of female directors from 12.5% to 25% in just five years. (The total number of female directors is lower than NED as there are far fewer women in executive than non-executive director positions.) In the other countries examined, India, China, and the US had no campaigns or legislative work done to promote gender diversity on board of directors. South Africa (SA)has Broad-Based Black Economic Empowerment legislation, which promotes both ethnic and gender diversity. China has less than 10% female representation in NED positions; this is underscored by the fact that there is no legislation requiring even one single woman to be appointed as a NED. Comparatively, India has mandated that one woman be appointed to the board, effectively doubling the percent of women on boards when compared to China.

The UK also boasts the highest number of nationalities on boards, with SA in second place. The economies of the UK and SA have long been built on export and trade. Culturally, it is expected to have more nationalities represented on these boards. Further, interest in expanding into new markets can often prompt the addition of a NED member from that country. As many UK and SA based firms are outwards focused, this has increased the numbers of nationalities on their boards.

The UK and the US have 100% independent NED membership, which was expected as increased shareholder value has been the primary focus of companies. Independent directors are able to provide outsider opinions, and are less tied to an organisation's vision. NEDs are internationally recognised to be a key component of 'good corporate governance'.India and South Africa have comparable levels of independent NED membership, and both countries are expected to converge towards 100% as legislative changes from the past ten years start to become commonplace. China has the lowest number of NEDs. This is due to a number of factors. Firstly, legislation requires only one third of directors to be independent. Culturally, Chinese companies will strive to meet but not exceed requirements; this results in many firms hovering around the 33-40% mark. Secondly, the role of the independent director is viewed as an 'Americanisation' of Chinese corporations, making this role poorly regarded.

Table-1: Summary of data from top 5 largest companies by market cap

Country	Board Size	# women	% women	Nationalities	Industry Diversity	Independent	C-levels
UK-FTSE	11	4	42%	6	Med-High	100%	7
US-DOW	9	3	30%	2	Med-High	100%	8
India-NSE	8	1	19%	2	Med-Low	90%	3
China-SSE	10	1	8%	2	Med-Low	49%	2
SA-JSE	12	3	24%	4	Medium	83%	9

**All averages are rounded to the nearest integer*

Country level

United Kingdom

The UK has the highest levels of diversity from a gender, nationality, and industry standpoint.

Table-2: Summary of United Kingdom NED board composition

Company	Board Size	# women	% women	Nationality	Industry Diversity	Ind.	C-levels
Royal Dutch Shell	9	3	33%	4	Med-High	9	6
Unilever	10	6	60%	7	High	10	7
HSBC	15	5	33%	7	Medium	15	9
British American Tobacco	10	4	40%	8	Medium	10	7
GSK	9	4	44%	4	Medium	9	5
Average	*11*	*4*	*42%*	*6*	*Med-High*	*1*	*7*

There is no binding legislation in the United Kingdom regarding board appointments and diversity. Rather, the UK Corporate Governance Code outlines a set of non-binding principles of good corporate governance aimed at companies listed on the London Stock Exchange. These state that for companies listed on the FTSE 350,at least half the board, not including the chairman, should be independent non-executive directors. The Code includes a "comply or explain" measure, allowing corporate boards to outline their own diversity policy.

United States

The US has high industrial diversity, and the highest proportion of NED with C-suite experience. In contrast, it has a low proportion of women, and reduced diversity on a nationality level.

Table-3: Summary of US NED board composition

Company	Board Size	# women	% women	Nationality	Industry Diversity	Ind.	C-levels
Apple	7	2	29%	2	Med-High	7	6
Alphabet	9	3	33%	3	Medium	9	5
Microsoft	10	3	30%	3	Med-Low	10	9
Amazon.com	9	3	33%	1	Med-High	9	8
Exxon Mobil	12	3	25%	2	Med-High	12	14
Average	*9*	*3*	*30%*	*2*	*Med-High*	*1*	*8*

There is no national policy in the United States that governs board appointment and diversity; however, there are state wide diversity policies in California, Illinois, and Massachusetts for companies that have headquarters in those states. The Securities and Exchange Commission (SEC) requires public companies to disclose if they consider diversity when searching for a new board member, but falls short of defining diversity, instead leaving it up to the discretion of the company. There are many public campaigns calling for increased female representation on boards, including Women's Forum of New York's (goal of 40% women), and the Thirty Percent Club (goal of 30% women).

India

India's corporate governance model appears to be converging towards a more globalised board composition, with fairly good representation of different nationalities, the number of independent directors, and its use of NEDs with previous C-level experience.

Table-4: Summary of India NED board composition

Company	Board Size	# women	% women	Nationality	Industry Diversity	Ind.	C-levels
Tata Consultancy	8	0	0%	3	Medium	6	3
Reliance Industries	9	1	11%	1	Low	8	2
HDFC Bank	6	1	17%	1	Med-Low	6	2
ITC	9	2	22%	1	Med-Low	8	3
Infosys	7	3	43%	3	Medium	7	5
Average	*8*	*1*	*19%*	*2*	*Med-Low*	*1*	*3*

India has recently updated its corporate governance guidelines. The Companies' Act of 2013 requires the following of Listed Companies: at least one female director, one third of directors be independent, one director who resided in India for more than half of the previous calendar year. No other references to diversity are made in the Act.

China

China has the least diverse boards of the five countries examined. Chinese firms have less than one woman on their board, on average, with two out of the five companies reporting no female board member at all. The nationalities of board members are primarily Chinese, with only three boards reporting one non-Chinese NED member.

Table-5: Summary of China NED board composition

Company	Board Size	# women	% women	Nationality	Industry Diversity	Ind.	C-levels
Petro China	7	0	0%	2	Med-Low	4	0
ICBC	12	2	17%	2	Med-Low	6	3
Agriculture Bank of China	11	1	9%	1	Med-Low	5	1
Bank of China	12	0	0%	1	Low	5	3
China Life	7	1	14%	2	Low	4	2
Average	*10*	*1*	*8%*	*2*	*Med-Low*	*0*	*2*

South Africa

SA's corporate governance model also appears to be converging towards a more globalised board composition, with good representation of different nationalities, the number of independent directors, and the number of female NED.

Table-6: Summary of South Africa NED board composition

Company	Board Size	# women	% women	Nationality	Industry Diversity	Ind.	C-levels
Standard Bank	12	2	17%	5	Medium	10	8
BHP Billiton	11	3	27%	5	Medium	11	7
Sasol	10	2	20%	4	Medium	10	6
FirstRand	18	4	22%	2	Med-High	11	16
MTN Group	9	3	33%	3	Medium	8	6
Average	*12*	*3*	*24%*	*4*	*Medium*	*1*	*9*

In South Africa, companies that are listed on the JSE are required to comply with the King Code of Governance for South Africa 2009 (collectively King III). King III states the following: the board structure must be unitary, listed companies must have at least three directors, the majority of the board should be independent and non-executive, and the board must be balanced in terms of age, nationality, diversity, gender and experience. There is a bill, pending second reading, which would legislate 50% female representation on boards. Additionally, there is the Broad-Based Black Economic Empowerment Act that defines the national empowerment strategy for historically disadvantaged people, with a particular focus on black people, women, youth, disabled, and rural communities.

Trends

Homogeneity of Chinese Boards

The findings showed that Chinese boards lacked in diversity on all levels- gender, industry, and nationality; only half of the NEDs are independent, and are often referred to as 'flower vase directors'. The legislation review showed that the most recent legislative changes in May 2015 failed to address the issue of diversity in its entirety.

There may be a number of reasons for why China is refusing to conform to globally-accepted best practices. Firstly, the top ten companies by market cap operate almost exclusively in China, meaning that these companies are not concerned with representation from other nationalities for purpose of market expertise. Secondly, of the top ten firms, only three of them are privately held. State-owned companies are prone to higher conformity with government policy, including a male-bias for board appointments.

If Chinese firms start to take more interest in moving into new markets, they will need to update their board structure accordingly. Increasing investor activism, paired with globalised norms will mean that Chinese companies that are unwilling to change will be leaving value creation behind.

India's Continued Push towards a Global Model Falls Short

The Companies Act that was introduced in 2013 resulted in significant changes to board structures, and many companies are still working towards implementing these changes. Most notably has been the requirement of public companies to have at least one woman on the board. This had led to a notable increase of the number of female NED, however, many of these women come from the promoter group, or from within the family, and should not be considered as suitable NED candidates. These appointments subvert any notion of gender diversity and independence.

India is on the path towards a globalised corporate governance model but must make stronger commitments to ensure commercial sustainability of its companies. As Indian companies start to foray into new markets, it will be imperative that they remain transparent and communicative with shareholders. Shareholders, in particular large institutional shareholder such as pension funds and unions, are becoming more involved in board management. In April 2016, BP's shareholders voted against increasing the CEO's, Bob Dudley, compensation package. Institutional Shareholders Services, an advisory group representing 20% of UK stock market investors, then proceeded to recommend voting against the pay packages of Anglo American's and Shire's CEO.

Shareholder activism is starting to push for more regular and dependable information from companies for diversity information. For example, there is pension funds' petition to the SEC called for candidates' gender, race, and ethnicity to be presented in a chart or matrix form as the current disclosure requirements, it is difficult for investors to ascertain the gender, racial, and ethnic diversity of directors, particularly if pictures and first names or pronouns are not used in the proxy materials.

To be able to attract large investors, Indian firms will need not only to convince them of their ability to adhere to good corporate governance practises but also that they are prepared to work with shareholders through these issues.

Use of Quotas to increase Gender Diversity

The use of quotas to increase women members on boards is a constantly debated topic. Many countries have introduced them, and the representation of women on boards has increased in accordance with the prescribed legislation. However, the UK is an example of a large increase of women on boards, not through the use of quotas. The UK introduced a voluntary, business led approach increase the number of women on FTSE 100 boards. Launched in 2010, the initiative saw the percentage of women on FTSE 100 companies more than doubled to 26% in just five years.

The approach that the UK has taken is distinct from quotas. The approach was to build a business case for increasing female representation on boards, and demonstrating the value-add of gender diversity. It is well documented that adding women to boards' increases attendance from all members, increases the frequency of meetings, changes the nomination process, and changes the design of compensation structures.This approach was selected after a poll of UK based business showed that just 11% of businesses supported a quota system. Involving businesses in the discussion helped to make them feel as if they were also part of the solution. What remains to be seen if this can be replicated in other countries, and if the UK model is more sustainable in the long run than quotas.

Next Steps

In summary, by examining the diversity indicators among non-executive directors across five countries, a convergence towards increased diversity on the board of directors is apparent. To continue to build towards this, we suggest that the following steps be taken. Firstly, countries must recognise that quotas and legislation are not always the best way to increase diversity of the boards of directors. The UK has made large increases in diversity through a voluntary initiative, instead of relying on quotas. Further, quotas in India have rubber stamped by companies or been largely ignored. In 2016, the Indian government fined 56 companies, including Tata, for failing to appoint a woman on their board. While a good start, the penalties must be stronger to induce change in these companies. Secondly, companies must recognise the rise of shareholder activism as an opportunity to bring about change. Increased communication and transparency with the shareholder is imperative to manifest these changes. Lastly, as the market becomes increasingly globalised, emerging and frontier economies must ensure that their board compositions are fit for purpose. Failing to diversify their boards will limit a company's ability to compete in the global economy.

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